

CORPORATE TAKEOVERS

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST,
MONOPOLIES AND BUSINESS RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

THE IMPACT OF HOSTILE CORPORATE TAKEOVERS

APRIL 2, 1987

Serial No. J-100-14

Printed for the use of the Committee on the Judiciary



U.S. GOVERNMENT PRINTING OFFICE

78-080

WASHINGTON : 1987

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

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CORPORATE TAKEOVERS

THURSDAY, APRIL 2, 1987

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST,
MONOPOLIES AND BUSINESS RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Howard Metzenbaum (chairman of the subcommittee) presiding.

Also present: Senators Thurmond, Specter, and Simon.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator METZENBAUM. The hearing will come to order.

I do not have to make the point that large, hostile takeovers are restructuring America. A new Harris Poll report released just this morning shows that the people of this country are concerned about corporate raiders and about corporate management.

The influence on shareholders and workers, managers, communities, and the market is absolutely profound. I have seen it in my own State, I have seen it happen throughout the country.

As in any situation, there are winners and there are losers. In the takeover game, quite often the biggest winners are the raiders. Some shareholders also win, and properly so, but there are too many outright losers.

Thousands of workers have lost their jobs in takeovers. Communities have been disrupted by the loss of major plants and the economic hardship has rippled through every local business. The impact on the local community quite often is unbelievable.

Greenmail has become an accepted form of resisting the takeover artists. Scorched earth anti-takeover tactics have cheated many shareholders of a fair return. Investor confidence has been shaken to the core by insider trading scandals fueled by takeover greed.

These abuses line bidders' pockets and save managers' jobs, but frankly they do precious little for the corporation, and the shareholders who own it, or the community which depends on it.

I want to make it crystal clear that I find nothing evil about one corporation wanting to buy another corporation or an individual or group of individuals wanting to buy into or take over another company.

But you have to look at the total picture. What is the objective? Is the objective to get the corporation to buy out the raider? What are the defensive tactics that are used by management? Are they

used in order to protect the corporation, the shareholders, or just the management?

The bottom line, in my opinion, is the overall impact of a hostile takeover. What happens to the workers, the community, the shareholders, and the corporation itself? Frankly, the stakes are too high for Congress to sit idly by any longer. Yet Boesky and other insider trading scandals have made hostile takeovers an issue on Main Street as well as Wall Street.

But it should be pointed out that if greenmail and some of the other takeover-related tactics did not exist, the Boeskys of this country would not be able to make the great killings they have made.

Congress must do much more than just react to the scandals. It must act against the system that produces them, the rules of the takeover game. Congress must act now, while outrage is high, or lose the chance to act at all.

I have been around here long enough to know that what is today's front-page news becomes but a shadowy memory many months afterwards. I remember when this Congress was determined to do something about those people who left government and went out and started representing people on the opposite side of the issue or using inside information gained while they were in the government.

While some special counsels were appointed to deal with that problem. Congress was also going to do something; we were raring to go. You do not hear a word about it anymore. That legislation is passé, and that is what will happen with this legislation if Congress does not grab the bit and run.

As I see my colleague, Senator Thurmond, just arrive, I remember when he and I were gung ho; we were going to do something about those people who had left government and gone to work for foreign governments or for corporations. We were so close to getting a bill to the floor and then we were not able to do it, and now it is but a dim memory in the eyes of many people.

My point, Mr. Ranking Member, is that timeliness has so much to do with whether or not you can pass legislation, and how you and I worked so hard on that other matter and today nobody even thinks about it.

Senator THURMOND. We have introduced the bill again this year.

Senator METZENBAUM. That is right.

Senator THURMOND. You all are in the majority now. Let us get it up and pass it. [Laughter.]

Senator METZENBAUM. I am with you, I am with you. We will do that.

The purpose of this hearing is to shed some light on what should be done and to pass that other bill that we were talking about as well.

Senator THURMOND. Yes.

Senator METZENBAUM. The answer does not lie in banning hostile takeovers. Despite the abuses, some takeovers do improve management and help achieve a company's potential. Congress should not tilt the takeover playing field one way or the other. It should only ensure that it is level and that it is fair.

I have introduced two bills to curb the most egregious abuses and ensure full shareholder participation and benefit in the takeover process. Shareholders, not self-interested managers, raiders or takeover professionals, should have the last word on whether a takeover is good or bad for their company.

My bills would ban greenmail, poison pills, and harmful defensive tactics unless the shareholders approve. It would extend the time for consideration of tender offers. It would close the 10-day window and it would restrict creeping and two-tier tender offers.

These bills restore balance, fairness, and a measure of caution to the takeover process. They ensure that takeovers will proceed in an orderly way. They ensure that owners of the corporations, not the managers or the bidders, will decide the outcome.

I am frank to say to you that these bills are not perfect. I am eager to consider alternative proposals of my colleagues. Together, we can and must forge a consensus on legislation to rationalize the takeover process.

Before we begin, I should observe that one of our invited witnesses, Clarence Johnson, Chief Executive Officer of Borg-Warner, has been distracted by a new possible takeover attempt by GAF and could not make the hearing today.

The Senate Banking Committee, headed by Senator Proxmire, has legislative jurisdiction over takeover reform, and I have been and will continue to work closely with Senator Proxmire in this area.

The purpose of this hearing is simply to conduct oversight and carry out this subcommittee's historical tradition of involvement in national antitrust and competition policy.

Senator Thurmond, we are very happy to welcome you, sir.

Senator THURMOND. Thank you very much, Mr. Chairman.

Mr. Chairman, we hear a lot about corporate takeovers these days, and such takeovers raise a number of concerns which will be discussed in today's hearing. As you know, about 2 years ago the full committee held a similar hearing to determine whether there is any evidence that hostile takeovers raise special antitrust problems.

A number of distinguished witnesses, including Mr. Boone Pickens, who will be with us today, testified at that hearing on May 1, 1985. I believe the consensus at that hearing was that hostile takeovers are no more likely to be anti-competitive than any other form of merger or acquisition.

Even so, it is clear that hostile takeovers often excite the emotions of those involved and do raise many other public policy questions having to do with taxation, corporate governance, shareholder rights, and securities regulation.

Mr. Chairman, while it is useful to explore the impact of hostile corporate takeovers on our society, as we proceed we should not lose sight of the common goal to keep our markets, including the markets for corporate stock, as free from restriction and control as possible.

I welcome our witnesses and look forward to their testimony. Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you.

Senator Specter, we are very happy to welcome you to the hearing.

Senator SPECTER. Thank you very much, Mr. Chairman. I am delighted to join you and Senator Thurmond here today and I commend you for scheduling these hearings.

There is a major problem which we are trying to address and find some improvement on. I recollect, as Senator Thurmond, the hearings which we held two years ago when there was a wave of oil mergers, and those mergers posed tremendous concerns for many of us.

I recall the impact of the takeover of Gulf by Chevron and the bid which was rendered by Mr. Pickens at that time, the witness who will be with us here today. The closest we came to any congressional action at that time was a proposal for a 6-month moratorium and it was debated hotly on the Senate floor and it was finally the decision of the Senate that we should not act because we might be causing more harm than we would be doing good; that if we acted, there would be uncertainties in the free market. We finally decided to take no action, and I joined in that vote.

Since that time, there has been a rash of additional problems. Senator Metzenbaum refers to investor confidence being shaken. I am not so sure that is true. Judging from what is happening in the stock market, investors are very anxious to go and buy, buy, buy.

Perhaps if there were really some evidence that the stock market was not functioning, we might be motivated to do something more. But I share the concerns which have been expressed here today about the major problems which are present in the stock market and have introduced legislation, Senate bill 634, which is a follow-up to legislation which I had introduced earlier, legislation dealing with a number of the issues which are present—greenmail, the creeping tender offers, some of the problems of Hart-Scott-Rodino, the issue of golden parachutes, uniform voting rights, the junk bonds.

I believe that we ought to do what we can, this committee and the Banking Committee, to deal with some of these egregious problems to the extent that we can realistically do so without causing more harm than good.

I regret that my schedule will prevent my being here this morning, but I will be studying the record closely and will have staff present. I am looking forward to working with you, Mr. Chairman, and with the ranking member, Senator Thurmond.

Thank you.

Senator METZENBAUM. Thank you, Senator Specter. We look forward to working with you.

At this point I wish to place the statement of Senator Hatch in the record.

[The prepared statement follows:]

OPENING STATEMENT OF SENATOR ORRIN G. HATCH

This morning the Antitrust Subcommittee is examining the volatile and complicated area of corporate takeover activity. Recent years have seen a decided increase in corporate takeovers and the effects of such activity on surrounding communities as well as targeted corporations has become the subject of heated debate.

Through this hearing we seek to identify and examine abuses prevalent in current takeover activity that are beyond the ability of the market to control. Concern

has arisen regarding both defensive tactics of management as well as certain bidder activity. A number of specific activities have been identified by experts as areas of concern, including the practice of greenmail, the use of poison pills, two-tier tender offers, and the adequacy of the time period and information provided while a tender offer is outstanding.

I appreciate this opportunity to hear the views of these experienced witnesses as they examine the specific problems involved in corporate takeover activity and propose solutions directed toward taming problems associated with mergers and acquisitions in restructuring corporate America.

Senator METZENBAUM. Our first witness this morning is a former mayor of the city of Akron, and presently a Congressman from that district, a good friend of the Chair's. We are happy to welcome you, Congressman Sawyer.

**STATEMENT OF THE HON. THOMAS C. SAWYER, A
REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO**

Mr. SAWYER. Thank you, Chairman Metzenbaum. I am pleased to have the opportunity to testify today and to join in this discussion of the consequences of hostile takeovers. I am going to try to summarize my remarks which I have made available to the Committee, and I would hope that they and some supplementary comments—

Senator METZENBAUM. Your entire remarks will be included in the record, Congressman.

Mr. SAWYER. Thank you, sir.

As you know, there has recently been a rash of takeover attempts against companies located in northeast Ohio and in my district, in particular. We have had the unfortunate distinction of witnessing firsthand the impact of these raids and what their effect has been not only on our corporations, but our community, our State, and the nation as well.

These effects can be seen in the aftermath of the failed takeover attempt last November of the Goodyear Tire & Rubber Company by corporate raider James Goldsmith. Goodyear, which is headquartered in Akron and is our city's largest employer, employs more than 12,000 locally and many more across the Nation.

Goldsmith used the so-called "partnership loophole" in the anti-trust law to avoid filing pre-merger notification requirements. Although interested observers knew that he was a raider, without this information it was impossible to understand what his intentions were with regard to Goodyear. We knew he was a European raider known for acquiring companies and stripping off their assets, as he did following his takeover of the San Francisco-based Crown Zellerbach Corporation.

So when he set his sights on Goodyear, a company that is operated in our area in our community for 88 years, he generated what can only be described as a crisis level of fear and uncertainty in northeast Ohio.

In an interview with the Akron Beacon Journal, Goldsmith said, "I am a potential bringer of change." The man is given to understatement because, unfortunately, that change came in the form of a \$2.6 billion takeover defense for Goodyear, and plant closings and job losses and early retirements not only in our community but all across the country due to the forced restructuring Goodyear is now undertaking.

Mr. Chairman, these are the results of a failed takeover attempt. Now, GenCorp, another major company that found its roots in the tire industry, has become the target of a hostile takeover. GenCorp, which makes tires and aerospace systems, plastics and industrial products, employs about 1,900 workers in the Akron area.

Early last month, GenCorp found itself facing an unexpected takeover by a partnership group called General Acquisition, which has launched a \$100-a-share tender offer for all of the company's more than 22 million shares. Financing of the offer would consist of about \$1.25 billion in junk bonds from Shearson Lehman Brothers and a \$250,000 loan from Wells Fargo.

Prior to the announcement of the tender offer, like Goodyear, GenCorp shares were trading at a level that was the product of measured growth. Last week, GenCorp stock had jumped to \$114 a share. This has ensured the partnership profits of at least \$50 million.

Before the offer was made public, GenCorp's stock had been steadily rising, but market analysts had attributed the rise to GenCorp's sale of RKO Broadcasting properties and other measured steps to refine its operations.

GenCorp had been moving to divest itself of radio and television stations, with the intention that funds from those sales would be used to repurchase stock. In the past several years, GenCorp management has taken steps to make the corporation more efficient and competitive, and their earnings have risen from \$7 million in 1984 to \$130 million last year.

They sold their stake in Frontier Airlines and other properties and strengthened Aerojet General through its involvement in new space and defense programs that will be the basis for its revenues in the next decade.

GenCorp, like Goodyear and other Akron-based companies, has been aiming itself toward redefining its business in terms of developing a future not only for themselves but for the workers and the communities that have invested in them.

GenCorp did not even have prior notice of that tender offer or that it was going to be made and found out about the offer only hours before an advertisement constituting that offer appeared in the Wall Street Journal.

The letter from the partnership to GenCorp which served as, and I use the term loosely, official notice of the tender offer was released to the financial community, the news media and others before it arrived at company headquarters. The management first saw the correspondence when it received a copy of the letter from an arbitrageur.

General Acquisition, the partnership that is engaged in the takeover, has announced that upon acquiring GenCorp it will sell off the Aerojet general subsidiary and RKO General's broadcasting and soft drink bottling operations, but retain the tire, plastics and industrial products segments of the company.

The announcement also said that GenCorp headquarters would remain in Akron and that it would try to maintain status quo employment there. Whatever the outcome, GenCorp, like Goodyear, will be a vastly different company. It may become more efficient in some terms of measurement, but there is a very real possibility

that the takeover could cost Akron and lots of other communities jobs that they have come to rely on.

These two examples illustrate a serious problem with takeover attempts, Mr. Chairman. Raiders are often motivated only by short-term profit and not in creating new jobs or products or in improving a company's competitive status or product quality or any of the other measures of corporate excellence.

In fact, at the time of Goldsmith's bid, Goodyear was leading the world in the highly competitive tire and rubber industry with a 23-percent share of the world market.

If I could summarize, Mr. Chairman, I think in recent years most acquisitions have not shown any economic benefit to our national economy. Instead, valuable time and money are expended in planning possible acquisitions or devising strategies to defend.

These are resources that will not be used in the kind of investment that is vital to our nation's competitive stature. All too often, the result of this kind of takeover is the raider simply walks away from the company, which is stripped of its assets, burdened with crippling debt, after he has pocketed his short-term profit.

When a company successfully defends itself against a takeover, the price it pays can mean long-term damage to operating efficiency, long-term job losses, and tremendous damage to communities. This is a real possibility even in the case of a strong, innovative and well managed company like Goodyear.

In the final analysis, many raiders do not recognize any responsibility to the employees of a company or to the communities who are unregistered stakeholders in their own right.

Hostile raids have caused fear and a crippling preoccupation with takeovers across America. I think it would be tragic if speculative manipulation of corporate ownership were to replace productive investment and competition as the basis for our free enterprise system.

Mr. Chairman, I strongly support your efforts in the introduction of legislation that will help curb these non-productive hostile raids.

Thank you very much for the chance to join you.

Senator METZENBAUM. Thank you very much, Congressman.

Congressman, as mayor of Akron, was Goodyear a good corporate citizen, supporting community activities and trying to help the community in various and sundry ways?

Mr. SAWYER. Mr. Chairman, Goodyear has been a pacesetter, a standard-setter for the kind of corporate citizenship, not only in terms of their charitable contributions, but in terms of public-private partnership that has spanned not only across northeast Ohio in partnership with educational institutions, governmental communities and other corporate citizens, but really across the nation.

Last December, I conducted a teleconference that reached into the hearts of 38 different communities all across this country. It involved mayors, State legislators, community developers, corporate citizens, labor leaders, and Congressmen who detailed in extraordinary measure, in dollars and cents terms, the kind of corporate citizenship that companies of this stature have meant to these communities and what their loss would entail.

Those dollars and cents, however, cannot measure the level of fear and concern that came out of those people.

Senator METZENBAUM. And I gather you would say that GenCorp was also a good community citizen?

Mr. SAWYER. Absolutely. They are the kinds of citizens that contribute not only to local communities, but to the competitive stature and, in fact, national security of an entire country.

Senator METZENBAUM. Congressman, I appreciate your support for my legislative effort, but much of your testimony was an outright condemnation of any takeover effort at all. I do not think that that is your position because, certainly, in a free enterprise system I do not think that Congress could be expected to say that in no instance may company "X" make an effort to buy company "Y" or individual "X" make an effort to buy company "Y."

Am I correct in my understanding of your position?

Mr. SAWYER. Mr. Chairman, I could not agree with you more. In detailing the consequences of the raids that we have seen in our community, I could really speak only in terms of the most non-productive kinds of takeovers.

But the fact of the matter is that we have even seen mergers in our community within the rubber industry that have been, I believe, of enormous benefit, have been responsibly done, and will have long-term productive results.

The supplementary positions that I brought to you, suggest that it is not this free flow of ownership, of productive capacity in this country that is in question, but rather the stripping of assets, the replacement of debt that diminishes the productive capacity of a nation and, in the narrow interest of short-term profit of a few, have diminished the long-term investment of the many.

Let me just mention one other point. During the very weeks that the Goodyear takeover attempt was being conducted under the shibboleth of shareholder value, we heard Secretary Baldrige and Deputy Secretary Darman criticizing corporate America for failing to take the longer view, for failing to invest in capital equipment and new plant and employee development and research and development.

And yet the very companies that we saw doing that kind of thing, investing in long-term productive capacity, were, in fact, made more fragile and more vulnerable to non-productive, hostile takeovers as a result of that long-term investment.

I think that is an aberration, a distortion of what we mean by the responsible exchange of ownership of corporate assets in this country.

Senator METZENBAUM. Thank you very much.

Senator Thurmond.

Senator THURMOND. Thank you, Mr. Chairman. I have no questions of the Congressman. We are glad to have you with us.

Senator METZENBAUM. Thank you very much, Congressman.

Mr. SAWYER. Thank you for the opportunity; I appreciate it.

[The prepared statement follows:]

STATEMENT BY REP. THOMAS C. SAWYER

Chairman Metzenbaum, Members of the Subcommittee, I am pleased to have the opportunity to testify today on the impact of hostile corporate takeovers, and in strong support of proposals you have introduced which would help protect corporations and consumers alike from corporate raiders.

Mr. Chairman, as you know, within the last four months there have been a rash of hostile takeover attempts against companies located in Northeastern Ohio, and in my District in particular. We have had the unfortunate distinction of witnessing firsthand the impact these raids have had on not only our corporations, but on our community, our state, and the nation as well.

These effects can be seen quite clearly in the aftermath of the failed takeover attempt last November of the Goodyear Tire and Rubber Company by corporate raider James Goldsmith.

Goodyear, which is headquartered in Akron, is our city's largest employer, employing more than 12,000 people locally. It is estimated that every Goodyear job supports 3 to 4 other local jobs. Goodyear also supports billions of dollars of economic activity in Akron by generating nearly one half billion dollars in direct income for its employees and \$300 million in direct supplier contracts.

Initially, it was unclear who was buying large blocks of Goodyear stock. It soon became known that James Goldsmith was behind the activity, but because of the so-called "partnership loophole" in the antitrust law, he was able to avoid filing pre-merger notification requirements with the federal government. Although interested observers knew Goldsmith was the raider, without this information it was impossible to fully understand what his intentions were toward Goodyear.

We knew that Goldsmith was a European raider known for acquiring companies and stripping off their assets, and as he did following his

takeover of the San Francisco-based Crown Zellerbach Corporation. When Goldsmith set his sights on Goodyear, a company that has operated in our area for 88 years, he generated a crisis level of fear and uncertainty in our community.

In an interview with the Akron Beacon Journal, Goldsmith said "I am a potential bringer of change." Unfortunately, that change came in the form of a \$2.6 billion takeover defense debt for Goodyear, plant closings, job losses, and early retirements due to the forced restructuring Goodyear is now undertaking. For Goodyear workers and their families, there is a lingering sense of insecurity about the future of their jobs, of Goodyear, and of their community.

And these are the results of a failed takeover attempt.

Now GenCorp, another major company that found its roots in the tire industry, has become the target of a hostile takeover. GenCorp, which makes tires, aerospace systems, plastics and industrial products, and owns broadcast properties and soft drink bottling operations, employs about 1,900 workers in the Akron area.

Early last month GenCorp — formerly General Tire and Rubber Company — found itself facing an unexpected takeover bid by General Acquisition, a partnership between Wagner & Brown, a Texas-based oil and gas company, and AFG Industries, a California-based glass manufacturer. General Acquisition has launched a tender offer for all of the company's shares, offering \$100/share for each of GenCorp's 22.3 million shares. Financing for the tender offer would consist of \$1.25 billion in junk bonds from Shearson Lehman Brothers, and another \$250 million loan from Wells Fargo.

Prior to the announcement of the tender offer, GenCorp share was trading at less than \$80/share. As of last week, it had jumped to \$114. This ensures the partnership profits of at least \$50 million.

Before the offer was made public, GenCorp stock had been steadily .

rising, but most market analysts had attributed the rise to GenCorp's sale of RKO broadcasting properties. GenCorp had been moving to divest itself of its radio and television stations, with the intention that funds from those sales would be used to repurchase stock.

For the last several years, GenCorp management has taken steps to make the corporation more efficient and more competitive. In fact, earnings have risen from \$7 million in 1984 to \$130 million last year. They have sold their stake in Frontier Airlines for a net profit of \$24 million; reached agreements to sell WOR-TV for \$387 million and KHJ-TV for \$217 million; propelled General Tire to its best earnings since 1977; substantially increased research and development, and strengthened Aerojet General's future through its involvement in important new space and defense programs that will be the basis for its revenues in the next decade.

These two examples illustrate the prevailing attitudes toward takeovers. Raiders are motivated by profit, which is fine as far as it goes. However, the real damage lay in the fact that many raiders are not interested in creating new jobs or products, or in improving a company's competitive status or product quality of any of the other measures of corporate excellence. In fact, at the time of Goldsmith's attempted takeover, Goodyear was leading the world in the highly competitive tire and rubber industry with a 23% share of the world market. The motive for Goldsmith's takeover bid was simply to increase his personal wealth, at the expense of Goodyear, our community, and our nation.

Hostile takeovers are often shrouded in secrecy, so a target company may not initially know who is buying large blocks of its shares. GenCorp did not have prior notice that a tender offer was to be made, and learned of the partnership's intentions only hours before an advertisement constituting their offer appeared in the Wall Street Journal. The letter from the General Acquisition partnership to GenCorp, which served as "official" notice of the tender offer, was released to the financial community, the news media, and others before

it arrived at GenCorp headquarters. GenCorp management first saw the correspondence when it received a copy of the letter from an arbitrageur.

General Acquisition announced that upon acquiring GenCorp, it intends to sell off the Aerojet General subsidiary and RKO General's broadcasting and soft drink bottling operations, but would keep the tire, plastics and industrials products segment of the company. The announcement also said that GenCorp headquarters would remain in the Akron area, and that it would try to maintain status quo employment there.

Whatever the outcome, GenCorp, like Goodyear, will be a different company, and there is a very real possibility that the bid could cost Akron, and lots of other communities, more jobs.

In the midst of the GenCorp situation, another another well-know raider, Harold Simmons, initiated a takeover several weeks ago over McDermott, the parent company of Babcock and Wilcox which is also located in my District and is our second largest employer behind Goodyear. Fortunately, Simmons' attempt fell through when he ran into problems with Panamanian securities laws, not, ironically, our own (McDermott is a Panamanian-based company).

Of course, the problem obviously is not limited to Ohio. According to Lee Trevor, an attorney with the Cleveland-based law firm of Jones, Day, Reavis and Pogue and the founder of Stakeholders in America, a coalition dedicated to countering hostile takeovers, there have been over 13,000 recorded merger and acquisition transactions since 1980. Moreover, Trevor estimates that for 1986 the total cost of acquisitions (\$150 billion) exceeded plant and equipment spending by American manufacturers by \$10 billion.

Most acquisitions, in recent years, have not shown any clear economic benefits to our national economy. Instead, valuable time and money are spent in planning possible acquisitions or on devising strategies to defend against hostile takeover attempts. These are

resources that won't be used for the investment that's vital to our nation's competitive stature.

Takeover mania has shown us that all too often the result of a hostile takeover is that the raider simply walks away from the company, stripped of its assets and burdened with crippling debt, after he's pocketed his short-term profit. And when a company successfully defends itself against a takeover, the price it pays can mean long-term damage to operating efficiency, long-term job loss, and tremendous damage to communities.

Remember, this is a real possibility even in the case of a strong, innovative and well-managed company like Goodyear.

Of course, the problem obviously is not limited to Ohio. According to Lee Trevor, an attorney with the Cleveland-based law firm of Jones, Day, Reavis and Pogue and the founder of Stakeholders in America, a coalition dedicated to countering hostile takeovers, there have been over 13,000 recorded merger and acquisition transactions since 1980. Moreover, Trevor estimates that for 1986 the total cost of acquisitions (\$150 billion) exceeded plant and equipment spending by American manufacturers by \$10 billion.

Most acquisitions, in recent years, have not shown any clear economic benefits to our national economy. Instead, valuable time and money are spent in planning possible acquisitions or on devising strategies to defend against hostile takeover attempts. These are resources that won't be used for the investment that's vital to our nation's competitive stature.

Takeover mania has shown us that all too often the result of a hostile takeover is that the raider simply walks away from the company, stripped of its assets and burdened with crippling debt, after he's pocketed his short-term profit. And when a company successfully defends itself against a takeover, the price it pays can mean long-term damage to operating efficiency, long-term job loss, and tremendous damage to communities.

Remember, this is a real possibility even in the case of a strong, innovative and well-managed company like Goodyear.

In the final analysis, many corporate raiders do not recognize any responsibility to the employees of a company, or to communities who are unregistered stakeholders in their own right.

Hostile raids have caused fear and a crippling preoccupation with takeovers across corporate America. It would be tragic if speculative manipulation of corporate ownership were to replace productive investment and competition as the basis for our free enterprise system. It is vital that we turn our attention back to the manufacture of competitive goods and the production of useful services. Hostile takeovers are wasting precious manpower and hard-won investment capital that would be better used in restoring the viability and competitiveness of our industrial sector through investment in new productive capacity — not wasted in the inflationary acquisition of existing capacity.

Chairman Metzenbaum, I strongly support your efforts in introducing legislation that will help curb these hostile raids.

April 2, 1987

I - Players and Motives

Through much of our recent economic history, a merger or takeover has occurred when one corporation assumed the operations of another for sound economic reasons: in order to consolidate a position in the industry or achieve economies of scale. Although some takeovers are still conducted by corporations with legitimate reasons for making an acquisition, increasingly, corporations are playing the takeover game for the short term, forsaking long term stability and growth for quick profits. Many takeovers are simply raids, conducted by corporations or individuals motivated simply by short term profit, with little concern for creating new jobs or products, or in improving a company's competitive status or product quality, or any of the other measures of corporate excellence.

A new breed of corporate raiders, and, increasingly, foreign interests, are playing a bidding game for the future of American industry, steering it into the short term even as other countries, through whatever methods, throw their efforts into research, product development, production, and sales.

II - Economic Effects

Takeovers play a large role in the current Wall Street boom. With hostile takeovers occurring at a rate of two a week, and overall mergers and acquisitions at a rate of 8 per day, trading in takeover stocks can reach as high as 10% of total daily market volume. The market boom is not built on solid economic criteria so much as on a shaky foundation of speculation. Prices increase not because of the actions of the company, but because of the actions of raiders and arbitrageurs who create demand for the stock, sending the price to extreme levels.

According to industry experts, in a rising market, many stocks could approach or surpass their 'true' market value. At that point, if the market continued to rise, it would do so based either on speculation, or because of real increases in profitability and productivity as companies increase their value. Yet, with stock prices bid high through largely speculative actions, further increases simply set up the market for a drastic 'correction' in the indeterminate future, which explains the focus on the short term.

Raiders operate on the principle that the whole is less than the sum of its parts, often paying premiums of 70-80% of the initial trading price of the stock, money which they will recoup from the sale of the target company's assets. To the extent that they explain their actions, raiders claim that they are helping allocate resources in the most efficient ways possible, accepting share price as a reliable index of corporate performance and potential, and conveniently defining efficiency as an auction to the highest bidder. Yet there is no way that many of these actions can be called efficient. Although corporate waste exists, many raiders make little effort to run companies efficiently, preferring to buy and sell for short term gain. Efficient actions would not lead to such large amounts of wasted time, thought, and money.

Efficiency is in danger of being evaluated solely in terms of the extent to which management is able to bolster the share price of the company's stock. However, because the market is not perfect, pressure is laid upon management to excel in the short-term rather than in long-term growth.

Takeovers allow raiders to transfer funds to themselves and a small group of arbitrageurs on a vast scale. Even when unsuccessful, raiders often pocket huge amounts of money, sometimes known as greenmail, a bribe payment from the target company which buys back the raider's shares at a vastly inflated price.

A company attempting a takeover often assumes a large amount of debt, which is usually recouped by the sale of assets, often those of the target company, and by cutting back its own operations, closing plants, laying off middle managers, etc. Even before the current wave, when most companies engaged in takeovers for more sound reasons, available data showed that the post takeover company was on the average no more profitable than the two pre-takeover companies. The only significant difference was the amount of debt, which had increased.

If the raid is successful, the target company will be absorbed and/or sold off piecemeal, and operations will be closed down as a result of consolidation. Although there is some justification for closing down inefficient operations, takeovers consume funds that could be used for investment and upgrading. Goodyear's Chairman of the Board, Robert Mercer, stated that Goodyear's Kelly-Springfield plant in Cumberland, Maryland could have been modernized with the funds used to fight off raider James Goldsmith.

If a company fights off a takeover, it is often weakened. Goodyear is a case in point. Fighting off Goldsmith meant divesting several divisions and taking on a large amount of long-term debt. Although it leads its industry in foreign markets, Goodyear's competitive status could be threatened as a result of this debt.

The alternative to increased debt, both for raiders and victims, is restructuring, though often, as with Goodyear, some combination of the two is necessary. Restructuring, when undertaken voluntarily, can be beneficial, but all too often a company must restructure not because of any failure in a product line or in management, but because a raider with a multi-billion dollar war chest is buying up their stock. Quite often, a division is not spun off as an independent company — a solution which could prove efficient — but simply sold to another company willing to add long term debt in exchange for short term profit.

One of the most crucial issues connected with takeovers is debt. A troubled company, by continually purchasing other firms, can make its balance sheet appear profitable, or at least produce a good cash flow for several years. This kind of approach forces the company into a pattern of buying and selling; if it tries to operate one of its purchases, it will have to make substantial profits to meet its debt service, and, as a consequence, will be lured once again into the easy money of the takeover market.

Often a takeover or defense is financed by junk bonds. However, investors demand a high rate of interest when buying junk bonds, so that the company pays the price tomorrow for easy money today. Fortune Magazine recently reported that close to 6% of junk bonds are in real danger of defaulting. In more general terms, the debt load of many companies is dangerously high today; debt/equity ratios of two or three to one are common. While junk bonds are neither the cause nor the effect of the takeover craze, the two are closely related, and both add uncertainty to American business.

As in any human endeavor, there is waste and inefficiency in American industry, and takeovers are beneficial where they combine assets that allow for economies of scale or appropriate integration of productive assets — or where they force companies to spin off unprofitable or superfluous divisions. Many companies have restructured in order to increase market confidence and effect a corresponding increase in share price. But increased efficiency does not have to be only a matter of closing and cutting back; it can also come from research, investment, upgrading, and modernization. Forced to be continually reactive, companies are expending time and money on takeover defense, with little chance to actually plan for the future.

III - Wider Effects

Economic factors go beyond statistics to have a great effect upon our society. Takeovers project the instability present on Wall Street

onto whole communities, destabilizing their way of life and making significant populations feel marginal, dependent on forces which they cannot control. The American challenge is to come to grips with difficult economic decisions without destroying communities and displacing thousands of workers.

The traditional workforce, in particular, is hurt by the takeover frenzy. With increased debt and less money going to investment, companies, under pressure to become more competitive, are scaling back, often laying off large blocks of workers. Restructuring can become an excuse to layoff workers and cut payroll costs. Companies will have even stronger incentives to shift operations abroad, where wages are often lower. But this could be dangerous in a sluggish economy, where the effect on overall demand of nationwide belt-tightening could bring down the G.N.P. and strain both public and private sector budgets.

Moreover, raiders and their supporters would have us believe that we have lost our competitive edge simply through a bloated blue-collar payroll. Yet Goodyear was able, before the takeover attempt, to maintain high wages and still make a healthy profit. From a social point of view, that is very efficient business. Now, however, there have been layoffs. It appears that the current merger activity is not the solution; it is not the kind of pruning which will lead to more jobs. Profits do not go into investment, but into further takeovers.

Small cities and towns are hurt. Relocated headquarters and closed factories erode a tax base, affecting basic services as well as funding for education and affirmative action programs on the local and state level. Abandonment of urban centers is exacerbated, leaving the inner city and even middle class city neighborhoods in a state of decay without the capacity to maintain and renew themselves. Raiders deny any social or communal responsibility or obligation for the results of their actions, yet takeovers can be disastrous for a community, and it is hard to see how these men, with their eyes trained only on individual profit, can truly escape responsibility.

The merger wars also have broader implications. A good example is the oil industry, where the combination of cheap oil and a merger wave within the industry has produced a dramatic cutback in the amount of research and exploration. Profits are shrinking, and many firms are more concerned with restructuring or paying off takeover debt than with planning for the future. When there is another oil shock, the country will pay the price even if some companies reap huge profits.

From a strategic view, shifting industrial jobs overseas is dangerous. While reasonable in terms of comparative advantage, our diminished industrial base would be hard pressed in the event of an emergency requiring a high production economy. The entrance of foreign players has the effect of shifting control over some corporate policies into foreign hands.

Finally, the effect of this preoccupation with finances and takeovers on the trade and balance of payments deficits is unclear. Again, our security could be damaged if, as a debtor nation, there is a crisis in international financial markets.

IV - Conclusion

Today's takeovers, fueled by speculation and the desire for quick profits, have effects that go far beyond the numbers on a balance sheet, helping to fuel the dislocation of segments of the population, the further shrinking of our industrial base, and the shift in focus from long term growth, development, and steady profit to a desire for quick pay-offs.

America must address takeovers in a way that allows corporations to shift their perspectives back to the long term, with a merger and acquisition process that is fair and open, so that rational decisions can be made on a sound economic basis. The desire for profit is a cornerstone of our economic system, yet profit is harmful when unconstrained by concern for production and development, or without a sense of responsibility to the workforce and community who are partners in the enterprise. Only by understanding takeovers in this larger context can we hope to deal with them in an efficient and productive manner.

Senator METZENBAUM. Our next witness is Commissioner Charles Cox from the Securities and Exchange Commission.

**STATEMENT OF CHARLES C. COX, COMMISSIONER, SECURITIES
AND EXCHANGE COMMISSION**

Mr. Cox. Chairman Metzenbaum, members of the subcommittee, I appreciate the opportunity to testify about the most recent proposals for reform of existing Federal regulation of tender offers.

Although the Commission has not yet considered the specific proposals before the Senate in the 100th Congress, it has studied many of the issues and taken positions on prior similar proposals or addressed these issues in other contexts.

The Commission's written statement summarizes its recent activity in the tender offer area and discusses issues that have been raised with respect to the types of reform presently under consideration. I ask that this written statement be included in the record.

Senator METZENBAUM. Without objection, it will be included in the record.

Mr. Cox. The recent dramatic growth of tender offer activity, as well as the increasing complexity of tender offer practice, has raised concerns about the adequacy of regulation in the takeover area. The Commission's ability to address potential new abuses under the Williams Act and the proper scope of Federal regulation generally have been the subjects of continuing Commission activity. Let me briefly highlight that activity.

In February 1983, the Commission established a tender offer advisory committee to review tender offer practices and to recommend specific regulatory improvements.

Senator METZENBAUM. When was that?

Mr. Cox. February 1983.

After reviewing the advisory committee's recommendations, the Commission submitted a package of legislative proposals to Congress in May 1984. Takeover practices and tactics continued to evolve, and in 1985 and 1986 the Commission hosted a series of roundtables attended by leading representatives of the business, legal and financial communities, and also held two open meetings where the need for additional legislation was discussed.

The Commission's review included consideration both of the need for additional investor protections and of the likely impact of proposed regulatory changes on an open market for securities and on the existing balance between bidders and targets in contest for control.

In January 1986, the Commission reaffirmed its decision to recommend legislation to modify the filing period provided in Section 13(d) of the Securities Exchange Act of 1934. However, the Commission determined that market forces, State actions, shareholder litigation and other factors had made additional legislation unnecessary or inappropriate at that time.

In July 1986, the Commission adopted its so-called all-holders and best-price rules to make explicit the requirement that all shareholders be treated equally during a tender offer. The Commission also issued a concept release seeking public comment on whether the Williams Act should apply whenever a person ac-

quires a substantial percentage of a target company's securities during or shortly after a tender offer, whether there should be a government response to the proliferation of poison pill plans, and whether the Commission should adopt a self-governance exception to certain provisions of its tender offer rules. A summary of the comments received was released last month, and they are currently being analyzed by the staff.

I thank you for this opportunity to testify. The Commission will be pleased to provide the subcommittee any assistance it requires in its inquiry into the adequacy of existing law.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you very much, Commissioner Cox. We are happy to have you with us.

The Commission has recommended that Congress close the 10-day window to 2 days. My bill would close it to 1 day and lower the disclosure threshold from 5 to 3 percent.

Would the Commission object to passage of that proposal?

Mr. Cox. I doubt that it would object to the closing of the filing period to 1 day rather than 2. It has not considered your specific proposal. Ever since it made its determination in 1984 to request legislation, it has been trying to get the filing period for 13(d) reduced from the 10 days to a shorter period.

Its most recent legislative proposal of last year suggested a 2-day filing period. I myself see little difference between the 1-day period that you suggested and the 2-day period that we suggested.

Senator METZENBAUM. I might say to you, Commissioner, that I originally proposed a 2-day filing period. But then many people said if we make it 2 days, why shouldn't we go a step further and require immediate disclosure rather than permit the raider, as the case may be, to have that extra 24 hours to go out and buy up as much stock as he or she can during that period.

So I do not think it is a matter of principle. I think it is a matter of practicality. There is not that much difficulty in filing in 1 day rather than 2 and the raider certainly has plenty of lawyers around.

Mr. Cox. I was going to suggest that the difference between 1 and 2 days, to me, would only come down to the physical possibility or the technology of getting the filing made. So from my standpoint it would only depend on that.

Senator METZENBAUM. And the 5 to 3 percent?

Mr. Cox. The Commission has considered in the past lowering the threshold below the 5 percent and concluded that the costs of doing so would outweigh the benefits.

The Commission gets a lot of 13(d) filings and amendments. During the past year, it got some 7,000 filings and amendments. When it examined the possibility of lowering the threshold below 5 percent—this was in 1980—it found that the filings and amendments would increase many-fold.

Most of those would have nothing to do with the types of tender offers that we are looking at, but only with investors that had some substantial holdings of shares. So I would have some reservations about lowering the threshold. I think that abuses can be corrected by getting that filing period down, and getting out more prompt

disclosure that an investor has established a substantial position in the company.

Senator METZENBAUM. Your prepared statement says that in light of recent greenmail incidents such as Goodyear/Goldsmith and CPC/International, Ronald Perelman, the Commission intends to reexamine the issue "to assess whether a Federal regulatory response is necessary."

Would the Commission object to the passage of some form of greenmail restriction? The soundings that I pick up around here are that there is almost unanimity that there ought to be a greenmail restriction?

The issue arises, frankly, from the feeling that management needs to be restrained, at the same time, from putting in place changes in their corporate structure that amount to poison pills or something similar thereto.

Mr. Cox. You are correct that the Commission when it last considered this concluded that market forces, shareholder litigation and State courts had the problem under control. In fact, we were not seeing cases of greenmail.

Recently, there has been a resurgence of greenmail payments. An example that is normally cited is the Goodyear/Goldsmith type of transaction. So the Commission has concluded that it will reconsider this.

I do not know what the Commission's decision will be. Three members of the current Commission were not on the Commission at a previous time it submitted its legislative proposal, which was very similar to the one in your bill to control greenmail payments.

Personally, I supported that legislative proposal at the time it was submitted. The only hesitancy I would have is whether certain share repurchases are so clearly a matter of State law that intrusion would be unwise. But it seems to me that the situation now is similar to the way it was when we did request the type of control that you are seeking.

Senator METZENBAUM. My greenmail bill would prohibit purchases from a 3-percent or more shareholder who has held the stock for less than 2 years unless a majority of the shareholders approve the purchase.

Is that a reasonable greenmail restriction, do you think?

Mr. Cox. Well, since that is approximately the proposition that I voted for when the Commission submitted its proposal, it seems reasonable.

Senator METZENBAUM. If you voted for it, it must be reasonable. [Laughter.]

You would not vote for anything unreasonable.

Mr. Cox. I try not to.

One aspect of the greenmail question that raises rather perplexing and troublesome issues about government intervention is that most of the greenmail transactions that are subject to criticism seem to occur when a potential bidder contacts a company and says I have substantial holdings in your company; you can buy those from me at a premium to market price or I will proceed and your company will be put in play.

Now, I can understand the concern of any management that says we do not want to be caught up in that; we do not want our atten-

tion diverted because our company is in play, there are takeover rumors, and so on, so let us buy him out.

Well, perhaps, but the people who are complaining about these kinds of raids, it seems to me, would have a very easy solution—to simply adopt a corporate charter provision that says we will not pay greenmail. It could be stated very similarly to what you have proposed and it would simply make it known that the company will not participate in these kinds of payments in order to get rid of someone. So there is that aspect to consider about it, too.

Senator METZENBAUM. You say the companies can do it by just saying they will not participate in those kinds of endeavors? Is that your point?

Mr. Cox. Well, the most recent information I have is that approximately 70 corporations had adopted charter provisions saying that they would not make these types of greenmail payments. I would think that would be fairly effective in keeping someone away that has no intention of making a tender offer, but simply wants to extract a greenmail payment.

Senator METZENBAUM. I think that that might be the case in some instances, but I will say to you that I know in the Goodyear case that I do not think they really wanted to pay greenmail, and I think they were as offended by it as am I and others.

But I think they found themselves in a bind and tried to make an arrangement for their shareholders where they would buy 40 percent of the shareholders' stock at the same price and then indicated they felt the stock price was going to go up and therefore the rest of the shareholders would not be hurt.

Yet, the fact is when the corporate officers find themselves in that bind, they are looking for a way out and they have both the pride of position and maybe some self-interest as well, but it is an understandable self-interest. It maybe should not be if you looked at it in a vacuum, but the fact is it is a reality of life. They have spent a lifetime building up a company and then suddenly one day they are out on the street.

So the question that I have is do we not need legislation rather than just wait for the corporate charters to be revised?

Mr. Cox. Well, the Commission has said that it will revisit the question, and I can only reiterate that previously we had submitted the legislative proposal which is about the same as yours. It remains to be seen what the Commission's decision on this question will be.

Senator METZENBAUM. Your prepared statement indicates that the Commission does not think it is necessary to extend the waiting period for tender offers. Why? Most Senators who have introduced takeover reform measures, including myself, think an extension is necessary to give shareholders and management more time to respond in a less pressured atmosphere.

Would the Commission object to a reasonable extension, and what would it consider reasonable?

Mr. Cox. Well, the Commission has not considered the current proposals that do extend the minimum offering period, but in the past, in the late 1970's, the Commission examined the question of the appropriate minimum offering period very extensively. In fact, over a 3-year period this was a continuing question.

At that time, it had suggested that 30 days was appropriate, but through comments, of which it got many from the public, and its own expertise, the Commission cut that back to 20 on the basis of what time period is needed for investors to become informed and to make rational decisions.

Now, I wish to point out that 20 business days is approximately a 1-month calendar period. In addition, there are provisions in the tender offer regulations whereby an increase in price, an increase in the percentage of shares sought, or a material change in any of the other terms of the tender offer requires an extension of the offering period.

So, on average, tender offers take longer than simply the minimum 20 days. I think the average is something like 28 days. The Commission has looked at this simply from the standpoint of investor protection and adequate time to disseminate information to the investors.

You suggested the need to give management time to respond. Now, if your purpose is to allow management additional time for defenses, that is something the Commission has not considered. Additional time would certainly provide management with time for additional defenses.

In fact, if Congress' wish is to say we will take away some of these defenses—we will take away greenmail, we will take away poison pills, but we will give you a longer offering period—I do not know quite how to evaluate that. It is like saying, well, we will take away an apple and a grape and we will give you an orange. I do not know how it comes out.

Senator METZENBAUM. No. Let us put it this way: Let us say if we take away certain rights of the raider, then we do not want at the same time just to play into entrenched management's hands.

So we are not looking at giving an apple for an orange, but rather trying to find a balance so that the shareholders and the workers and the community and the management all get a fair deal. That is really what this Senator's objective is.

It is not to protect management; it is not to protect the raiders. It is to make the rules of the game fair. It is not right to ban greenmail and at the same time not restrict with respect to management's use of poison pills and other harmful antitakeover tactics.

So we are trying to find that balance, and that is what we need some guidance from the SEC on.

Mr. Cox. I understand. That is our goal, too, Senator. What I did say was that looked at from the standpoint of investors, where they are getting information about the tender offers and evaluating it, we found that the 20-day minimum period is adequate.

In an any-or-all offer, we find approximately 90 percent of the shares are tendered. So it is not as though the shareholders are not getting their information.

Senator METZENBAUM. The fact is, and do you not agree as a member of the SEC, that in that 20-day period the sophisticated investor knows what to do and where to get the information they need?

It is the small shareholder who quite often is left by the wayside, and that is a concern for the SEC as well as for us in Congress.

Mr. Cox. Certainly, Senator, that was not only considered by the Commission when it reached the conclusion on 20 days in 1979, but implicitly it was considered again in 1982 when the Commission extended the pro-rata period to correspond to the minimum offering period because we asked, Are people getting the information? Are they able to respond?

We were very considerate of the small shareholder in that kind of situation.

Senator METZENBAUM. Mr. Cox, I have a number of other questions, but I think I am going to submit them to you in writing so that we not cut off other witnesses today, because I expect a vote on the highway bill sometime this morning and I think that is going to disrupt us.

Mr. Cox. I will be pleased to respond to those in writing.

Senator METZENBAUM. Thank you.

[Response to questions follow:]

STATEMENT BY CHARLES C. COX
COMMISSIONER OF THE SECURITIES AND EXCHANGE COMMISSION
IN RESPONSE TO QUESTIONS SUBMITTED FOR THE RECORD
BY SEN. HOWARD M. METZENEUM, CHAIRMAN
SENATE SUBCOMMITTEE ON ANTITRUST, MONOPOLIES
AND BUSINESS RIGHTS

CONCERNING THE REGULATION OF TENDER OFFERS

MAY 20, 1987

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QUESTION: THE COMMISSION PROPOSED A LEGISLATIVE BAN ON POISON PILLS IN 1984 AND SOUGHT COMMENT ON THIS LAST JULY. OTHERS AND I HAVE INTRODUCED BILLS TO BAN POISON PILLS. WOULD THE COMMISSION OBJECT TO PASSAGE OF A BAN?

Answer: The Commission release referred to in your question requested comment on recent developments in poison pills and on whether a legislative or regulatory response is required. The responses are still under review by the staff, and no formal action has yet been recommended to the Commission. Therefore, I cannot say whether the Commission would object to any ban on poison pills.

The Commission's 1984 legislative proposal would have limited grants of voting power or issuances of securities during the course of certain tender offers or proxy contests, without shareholder approval. Issuers would also have been prohibited from repurchasing their securities during such tender offers and proxy contests. These provisions would have prohibited the adoption of "poison pills" granting additional rights or securities to shareholders and the redemption of such securities. These provisions would not have extended to "poison pills" adopted before a tender

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offer or proxy contest had commenced, nor would they have extended to "poison pills" granting targets' shareholders rights to acquire securities of the bidder.

In January 1986, the Commission reexamined its position on "poison pills" and determined to issue a concept release seeking comment on recent developments in the evolution of "poison pills" and whether legislation or regulation was an appropriate response to those developments. 1/ Seventy commentators addressed the specific issue of the appropriate characteristics of or forum for regulation of "poison pills." Forty-four supported some form of action at the national level. Twenty-one commentators either disfavored any regulatory response or expressed the view that the question should be left to the discretion of the individual states. The majority of commentators who favored a federal response suggested that such response should come through Commission rulemaking action. Only two commentators recommended legislative action. The commentators were also divided on what action should be taken. Twenty-three favored an outright prohibition against "poison pills," thirteen favored requiring shareholder approval for such plans, and eight recommended other types of action. 2/

1/ See Securities Exchange Act Release No. 23486, at 68 (March 19, 1987).

2/ See id. at 66-71.

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The Commission's staff has been evaluating the comments received and considering whether to recommend to the Commission any regulatory response as necessary or desirable.

QUESTION: YOU TESTIFIED THAT THE COMMISSION SOUGHT COMMENT LAST JULY ON WHETHER THERE SHOULD BE RESTRICTIONS ON SUCH PRACTICES AS "SWEEPING THE STREET." WOULD A PROVISION THAT REQUIRED THE ACQUISITION OF MORE THAN 15% OF OUTSTANDING STOCK BE MADE ONLY BY TENDER OFFER ADDRESS THIS PROBLEM?

Answer: While proposals to prohibit substantial acquisitions except by tender offer, such as the one you suggest, would address concerns raised in the Commission's request for comment, they raise additional substantial policy issues relating to whether federal law should guarantee equal participation by shareholders whenever control of a public company is shifted. ^{3/} Proponents of such legislation argue that a person acquiring corporate control through gradual acquisition may do so without paying the control premium usually associated with such control, thus acquiring a valuable corporate asset without having to pay for it. Proponents also argue that prohibiting the transfer of control except by tender offer allows smaller shareholders to obtain a portion of

^{3/} See Staff of House Subcommittee on Telecommunications, Consumer Protection and Finance of the Comm. on Energy and Commerce, 99th Cong., 2d Sess., Corporate Takeovers: Public Policy Implications for the Economy and Corporate Governance 85 (Comm. Print 1986).

the control premium, when they would not have had the opportunity to participate in the premium if control were transferred in an open market or privately negotiated purchase. Opponents of the proposed legislation argue that requiring that all substantial acquisitions be made by tender offer could impose significant additional costs on both purchasers and sellers of blocks of shares, regardless of whether any change in control is involved. They urge that purchasers could be constrained from employing more suitable alternative methods of structuring purchases. They further argue that shareholders with large blocks of shares could be denied the opportunity to liquidate their holdings except by selling them on the open market, which might depress the value of the stock overall, while simultaneously denying the shareholder any premium that the block might otherwise command.

In 1986, the Commission specifically considered whether to take steps to require all substantial acquisitions to be accomplished by means of a conventional tender offer but concluded that such an approach was not necessary for the protection of shareholders and that it would impede legitimate open-market purchase programs.

However, the Commission determined to seek comment in a somewhat different area. The Commission's 1986 concept release sought comment on whether buyers should be deemed to have made a tender offer when they use the circumstances created by a preexisting tender offer to acquire control of a company in circumstances where, absent the preexisting tender offer, the acquisition could

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only have been accomplished by means of a conventional tender offer. The concept release sought comment on whether regulatory action was necessary to assure that substantial purchases during or immediately following the termination of a tender offer are made in compliance with the Williams Act. 4/ The Commission was concerned by two recent court decisions holding such purchases to be outside the scope of tender offer regulation, and sought comment on whether these purchases present the same investor protection concerns as conventional tender offers. 5/

The Commission received 23 comments in response to this request. Thirteen commentators favored some form of application of the Williams Act and the rules promulgated thereunder to substantial share acquisitions during or shortly after a tender offer. Two commentators expressed concern but did not take a specific position. Five commentators opposed application of Williams Act protections or found it unnecessary or inappropriate. Two commentators noted that current regulations provide shareholders with adequate protection, but did not specifically oppose new initiatives. And one commentator believed that any action in this area would only be a temporary solution. 6/

4/ See Securities Exchange Act Release No. 23486, at 9-10 (July 31, 1986).

5/ Id. See Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985); SEC v. Carter Hawley Hale Stores, Inc., 760 F.2d 945 (9th Cir. 1985).

6/ See Securities Exchange Act Release No. 23486, at 27-30.

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QUESTION: THE SECURITIES INDUSTRY ASSOCIATION AND CAPITAL MARKETS GROUP HAVE ANNOUNCED TAKEOVER REFORM PROPOSALS OF THEIR OWN. DO YOU HAVE ANY VIEWS ON THEIR PROPOSALS?

Answer: The majority of the proposals made by the Securities Industry Association and Capital Markets Group address issues that were discussed in the Commission's written testimony. Three proposals raising issues not previously discussed are: a proposal to increase the sanctions associated with a failure to comply with Section 13(d) of the Securities Exchange Act; a proposal to limit the quantity of common stock or size of an equity interest that a target company may issue as a "lock-up" device without approval from its shareholders; and a proposal to provide for explicit federal preemption of state takeover statutes.

Increased Sanctions for Failure to Comply With Section 13(d)

The Commission has not specifically considered whether the sanctions for violations of Section 13(d) should be increased. The Commission has recommended reducing the time for filing beneficial ownership statements under Section 13(d) in order to increase the effectiveness of Section 13(d). At present the Commission has various remedies to redress actual violations of the requirements of Section 13(d). The Commission has authority under Section 21(d) of the Securities Exchange Act to initiate a civil action in federal district court to obtain an injunction against further violations and other appropriate

ancillary relief. The Commission may institute administrative proceedings under Section 15(c)(4) of the Exchange Act, in which, after notice and opportunity for hearing, the Commission may issue an order requiring the violator to comply or to take steps to effect compliance upon such terms and conditions and within such time as the Commission may specify. The Commission may also institute administrative proceedings under Section 15(b) for violations by a registered broker or dealer or any person associated with a broker or dealer.

Reduced Issuer Discretion to Issue Securities to a Preferred Acquiror

Proponents of legislation to limit issuers' authority to employ "lock-up" devices argue that such devices may effectively preclude any non-negotiated takeover of the target company. Opponents of such legislation, while recognizing the potential for abuse inherent in "lock-up" devices, argue that such devices are appropriately controlled through application of principles of state law and that federal intervention is unwarranted.

The Commission's Tender Offer Advisory Committee considered the issue of whether a limitation should be placed on issuers' authority to issue shares in an effort to defeat a hostile bid. The Committee recommended that, during a tender offer, the issuance of stock representing more than 15% of the fully diluted shares that would be outstanding after issuance should be subject to shareholder approval.

After reviewing the Committee's recommendation, the Commission decided in 1984 to propose legislation to require shareholder approval for any issue of more than 5% of the voting power of a class of securities during certain tender offers and contests for control.

In May 1985 the Commission decided not to repropose this legislation. This decision was affirmed by the Commission in January 1986. At that time the Commission concluded that abusive "lock-ups" were being adequately controlled by state law.

Explicit federal preemption of state takeover statutes

The relationship between state and federal regulation of the tender offer process is currently governed by the Supremacy and Commerce Clauses of the Constitution. A state takeover statute violates the Supremacy Clause if it conflicts with the provisions or frustrates the purposes of the Williams Act and the rules promulgated thereunder. ^{7/} A state takeover statute is invalid under the Commerce Clause if it imposes an excessive burden on interstate commerce. ^{8/} A number of state takeover statutes have been invalidated on Commerce and Supremacy Clause grounds. ^{9/}

^{7/} See Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-143 (1963); Hines v. Davidowitz, 312 U.S. 52, 67 (1941).

^{8/} Pike v. Bruce Church 397 U.S. 137 (1970).

^{9/} See, e.g., Edgar v. MITE Corp., 457 U.S. 624 (1982); Fleet Aerospace v. Holderman, 796 F.2d 135 (6th Cir.), rem. Ohio v. Fleet Aerospace, No. 86-344 (U.S. Apr. 27, 1987); L.P. Acquisition Co. v. Tyson, 772 F.2d 201 (6th Cir. 1985);

(footnote continued)

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However, on April 21, 1987, the Supreme Court upheld the validity of the Indiana Control Shares Acquisition statute in CTS Corporation v. Dynamics Corporation of America. 10/ The Commission has, through its amicus curiae program, challenged the validity of state statutes that impede the operation of the federal tender offer process, and did so in the CTS case. The Commission's staff is continuing to monitor developments in reaction to the CTS decision.

QUESTION: DOES THE SEC THINK THAT THE USE OF JUNK BONDS SHOULD BE RESTRICTED IN ANY WAY? HOW?

Answer: The term "junk bonds" generally refers to high yield, non-investment grade securities that have not been rated by a nationally recognized rating service. In 1986 the Commission determined not to support action to prohibit or limit the use of below investment grade securities to finance tender offers. At that time the Commission expressed opposition to the imposition, in effect, of merit regulation on such securities and supported continued reliance on full disclosure to protect the interests of investors.

(footnote continued)

9/ Televest v. Bradshaw, 697 F.2d 576 (4th Cir. 1983); Mesa Petroleum v. Cities Services Co., 715 F.2d 1425 (10th Cir. 1983); Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558 (6th Cir. 1982); Terry v. Yamashita, 634 F. Supp. 161 (D. Haw. 1986); Gelco Corp. v. Coniston Partners, 652 F. Supp. 829 (D. Minn 1985), appeal dismissed 811 F.2d 414 (8th Cir. 1987); Ichan v. Blunt, 612 F. Supp. 1400 (W.D. Mo. 1985); Sharon Steel Corp. v. Whaland, 466 A.2d 919 (N.H. 1983); Esmark Inc. v. Strobe, 639 S.W.2d 768 (Ky. 1982).

10/ 55 U.S.L.W. 4478 (Apr. 21, 1987).

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The role of "junk bonds" in tender offer financing has recently received a great deal of public attention. However, "junk bonds" are not the most significant source of tender offer financing nor is tender offer financing the most important use of funds raised with such securities.

While tender offers are increasingly financed through some form of debt issue, the proportion of non-investment grade debt used for this purpose has recently been in decline. Prior to 1985, issues of debt securities played a very minor role in tender offer financing. Between 1981 and 1984, debt issues of all kinds represented no more than 1.1% of all tender offer financing in any single year. The use of debt financing increased significantly in 1985: debt issues of all types represented 15.9% of tender offer financing. In 1986 the use of all types of debt issues continued to rise, representing 29.0% of tender offer financing. In comparison, the relative use of non-investment grade debt has been less significant, and appears to be declining. From July 1985 through December 1985 non-investment grade debt accounted for 11.1% of tender offer financing. From January 1986 through September 1986 the use of noninvestment grade debt fell, accounting for only 7.6% of tender offer financing. ^{11/}

^{11/} Noninvestment Grade Debt as a Source of Tender Offer Financing, Office of the Chief Economist, Securities and Exchange Commission (June 20, 1986); Junk Bonds and Tender Offer Financing, Investor Responsibility Research Center (January 1987).

Moreover, many companies that desire to raise funds by issuing debt securities must issue so called "junk bonds." Only a small number of companies qualify to issue investment grade securities. At present, high yield securities are primarily issued by companies with substantial assets that nonetheless do not qualify for investment grade ratings. In December 1985, the Congressional Research Service estimated that of the approximately 4800 United States companies with assets of more than \$25 million, only 9% had investment grade ratings. 12/

12/ Report of the Congressional Research Service on The Role of High Yield Bonds [Junk Bonds] in Capital Markets and Corporate Takeovers: Public Policy Implications, 99th Cong., 1st Sess. 21 (1985)

Senator METZENBAUM. Senator Thurmond.

Senator THURMOND. Thank you, Mr. Chairman.

Mr. Cox, we are very glad to have you with us and I do not think I have any particular questions. We have some other witnesses we are going to take up in just a minute. Thank you very much.

Mr. Cox. Thank you.

[The prepared statement follows:]

STATEMENT OF CHARLES C. COX,
COMMISSIONER OF THE SECURITIES AND EXCHANGE COMMISSION
BEFORE THE SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND
BUSINESS RIGHTS OF THE SENATE JUDICIARY COMMITTEE

CONCERNING FEDERAL REGULATION OF TENDER OFFERS

April 2, 1987

Chairman Metzenbaum and Members of the Subcommittee:

I appreciate the opportunity to testify about the most recent proposals for reform of existing federal regulation of tender offers. Although the Commission has not yet considered the specific proposals before the Senate in the 100th Congress, it has studied many of the issues and taken positions on prior, similar proposals, or addressed these issues in other contexts. Part I of this statement summarizes the Commission's recent activity in the tender offer area and Part II discusses issues that have been raised with respect to the types of reform presently under consideration.

I. RECENT COMMISSION ACTIVITY

The Williams Act Amendments to the Securities Exchange Act of 1934 comprise the principal federal regulation of tender offers and disclosure requirements for substantial acquisitions of publicly-traded equity securities. 1/ The Williams Act was

1/ The Williams Act, enacted in 1968 and amended in 1970, added Sections 13(d), 13(e), 14(d), 14(e), 14(f) to the Securities Exchange Act. Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 454; Act of Dec. 22, 1970, Pub. L. No. 91-567, 84 Stat. 1497 (codified at 15 U.S.C. 78m(d)-(e) and 78n(d)-(f) (1970)).

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intended to provide investors with information about substantial acquisitions of an issuer's securities that might result in changes in corporate control. It was also intended to provide certain substantive protections to investors confronted with a tender offer as well as adequate information and opportunity to make informed investment decisions. The Williams Act establishes a two-pronged regulatory scheme designed to preserve a free and open market for most securities transactions and to promote a policy of neutrality in the regulation of tender offers that favors neither bidders nor targets. These principles have guided the Commission's administration of the statute.

The recent dramatic growth in tender offer activity as well as the increasing complexity of tender offer practice has raised concerns about the adequacy of regulation in the takeover area. The Commission's ability to address potential new abuses under the Williams Act and the proper scope of federal regulation generally have been the subjects of continuing Commission review. The Commission's review has included consideration both of the need for additional investor protections, and of the likely impact of proposed regulatory changes on an open market for securities and on the existing balance between bidders and targets in contests for control. Where the Commission has determined that reform or clarification of certain aspects of the law is desirable, the Commission has made legislative recommendations, undertaken rulemaking initiatives, filed

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enforcement actions or participated as amicus curiae in private cases presenting novel or important issues.

In February 1983 the Commission established a Tender Offer Advisory Committee whose mandate was to review tender offer practices and regulations and to propose specific regulatory and legislative improvements. The Commission received the Committee's report in July 1983 and, after reviewing the Committee's recommendations, submitted a package of legislative proposals to Congress in May 1984.

Takeover practices and tactics continued to evolve over this period. 2/ While defensive tactics dominated the concern of lawmakers and public commentators in 1984, in early 1985 concerns also developed about bidder activity. 3/ In May 1985 the Commission held a public meeting to reexamine its proposals in light of changing market conditions, court decisions and legislative initiatives of the previous year. The meeting was attended by representatives from private industry, the New York Stock Exchange, the Business Roundtable, the Office of Management and Budget, and the Tender Offer Advisory Committee. While many of these representatives were critical of corporate antitakeover activities, they opposed reintroduction of many of the Commission's 1984 legislative proposals. They stated

2/ See Report of House Subcommittee on Telecommunications, Consumer Protection and Finance on Corporate Takeovers: Public Policy Implications for the Economy and Corporate Governance (December 29, 1986) at 13.

3/ Id.

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that they preferred to rely on the discipline of the marketplace and on court decisions to regulate takeovers rather than to seek preemption of state law through federal legislation.

The Commission subsequently reviewed its 1984 legislative recommendations and decided to resubmit only one of its earlier proposals. This was the recommendation to amend Section 13(d)(1) of the Securities Exchange Act of 1934 to reduce the time period within which persons acquiring beneficial ownership of more than 5% of a company's shares are required to disclose their purchases.

In September and November 1985, the Commission hosted roundtables attended by Commission members and leading representatives of the business, legal and financial communities to discuss public policy issues raised by developments in the securities industry and financial markets. Topics of discussion included tender offer regulation, high yield bonds and various issues of corporate governance. The panelists reached no consensus of opinion on whether there should be a statutory or administrative response of any kind to various practices associated with contests for corporate control, or, if there were to be a response, what it should be. Participants seemed to agree that, because of the dynamic nature of the takeover area, legislation designed to confine or limit any particular practice would probably be ineffective.

At an open meeting on January 9, 1986, the Commission again considered a wide range of takeover issues in an effort to

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determine whether Commission action was necessary or appropriate. At that meeting, the Commission decided to recommend a revised version of its legislation to amend Section 13(d)(1). The Commission determined that no other legislation should be recommended at that time, but the Commission did authorize the issuance of a concept release to solicit public comment on three specific issues related to takeovers and contests for corporate control, and also adopted certain amendments to its tender offer regulation. Each of these is discussed below.

The concept release sought comment on whether the Williams Act should apply whenever a person acquires a substantial percentage of a target company's securities during or shortly after the expiration or voluntary termination of a tender offer, whether there should be a government response to the proliferation of "poison pill" plans, and whether the Commission should adopt a self-governance exemption to certain provisions of its tender offer rules. 4/ The inquiry as to whether the Williams Act should apply to substantial acquisitions of a target company's shares during or shortly after a tender offer was intended to respond to concerns raised by recent court decisions holding such purchases to be outside the scope of the Williams Act. 5/ The Commission had taken the

4/ See Release No. 34-23486 (July 31, 1986).

5/ See SEC v. Carter Hawley Hale Stores, Inc., 760 F.2d 945 (9th Cir. 1985) (The Commission sued Carter Hawley on the ground that the purchase program constituted an unconventional tender offer that should have complied with the

(footnote continued)

position in those cases that those types of purchases can present the same investor protection concerns as conventional tender offers, which are required to be made in compliance with the Williams Act.

The Commission also noted that "poison pills" were a continuing area of concern. The Commission had participated as amicus curiae in Moran v. Household International, Inc., a case in which the Delaware Supreme Court upheld Household's implementation of a "poison pill" plan without shareholder approval. 6/ The Commission believed further inquiry into such questions as the incidence and effectiveness of "poison pills" was warranted, and sought comment on the appropriateness of and proper forum for any regulatory initiative in this area.

The Commission also sought comment on whether the public interest would be served if individual corporations were permitted, under certain circumstances, to elect not to be governed by certain tender offer regulations, but rather to craft other safeguards designed to suit their specific circumstances. The

5/ (Continued)

Williams Act and the regulations thereunder. The Ninth Circuit rejected the Commission's position.); Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985) (The Commission, at the request of the Second Circuit, filed an amicus brief in which it expressed the view that the bid termination and immediate purchases raised sufficiently substantial questions under the Williams Act to justify the district court's issuance of a preliminary injunction. The Second Circuit did not agree.).

6/ Moran v. Household International, Inc., 500 A.2d 1346 (Del. 1985).

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Commission noted that, unlike certain other provisions of federal and state law, the Williams Act and the Commission's tender offer rules currently operate as rules of general applicability with no provision for modification by stockholder or director action. 7/

At the January 1986 meeting the Commission also adopted amendments to its rules concerning issuer tender offers to conform most of the time periods governing issuer tender offers to those governing third-party tender offers. Specifically, the amendments made issuers subject to the same minimum offering periods and periods for front-end withdrawal rights and proration rights as were applicable to third party bidders.

In July 1986, the Commission adopted its "all-holders" and "best-price" rules for issuer and third party tender offers. 8/ These rules were intended to provide clarity and certainty in the tender offer regulatory scheme by making explicit the requirement of equal treatment of security holders. The "all-holders" rule provides that both issuer and third party tender offers must be open to all holders of the class of securities subject to the tender offer. The "all-holders" requirement

7/ The comment period on the concept release ended on December 1, 1986. The Commission staff has been reviewing the comments received in order to evaluate whether a regulatory response to these issues is necessary or desirable. See Release No. 34-23486 (March 19, 1987) for a summary of comments received by the Commission.

8/ Release No. 34-23421 (July 11, 1986).

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does not prohibit tender offers for fewer than all outstanding securities of a class or limit the use of two-tier offers. It simply prohibits discriminatory tender offers by requiring that all security holders be afforded the opportunity to accept the tender offer if they so choose. The "best-price" provision requires offerors to pay a tendering security holder the highest price paid to any other tendering security holder during the tender offer.

At the same time the Commission amended existing rules regarding minimum offering periods so that a tender offer must now remain open for ten business days following the announcement of an increase or decrease in either the percentage of securities sought or the consideration offered. ^{9/} This amendment was intended to assure that shareholders have sufficient time to evaluate a revised offer and to withdraw their shares if they deem it appropriate. The Commission also amended its rules to require that withdrawal rights extend throughout the offering period, and repealed its rule that provided for the extension of withdrawal rights upon the commencement of a competing bid. The purpose of those revisions was to simplify the tender offer process so that shareholders need be concerned only with the expiration date of the offer and to reduce the potential for gamesmanship in commencing competing bids.

^{9/} Id. The offering period must also remain open following other material changes in the terms of the offer or in information concerning the offer. See infra pp. 15-16.

II. CURRENT LEGISLATIVE PROPOSALS TO AMEND TENDER OFFER REGULATION

There are presently six proposals before the Senate to amend the Williams Act provisions of the Securities Exchange Act of 1934. The Commission has not yet considered the various proposals before the Senate in this session of Congress. During the 99th Congress, the Commission recommended legislation to modify the filing period provided in Section 13(d) of the Securities Exchange Act, but concluded that no other legislation in the takeover area was warranted at that time.

Many of the current bills include proposals that would modify Section 13(d)(1), as recommended by the Commission, to reduce the length of time within which persons who obtain beneficial ownership of five percent of a class of a company's securities are obligated to file a disclosure statement with the Commission. Various other proposals would also alter or limit current tender offer market practices. Some would prohibit issuers from making certain targeted repurchases that eliminate specific takeover threats. Others would extend or modify the minimum offering period for tender offers. Limitations on the use of partial and two-tier tender offers have been proposed, as have requirements that acquisitions of equity securities beyond a threshold percentage be effected through tender offers. One proposal would prohibit adoption of extraordinary compensation packages for issuers' officers and directors once a tender offer has commenced. There are also proposals to limit the ability of issuers to employ certain defensive tactics such as

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issuing securities with extraordinary rights, or restructuring the target company. Issues presented by such proposals, and the views expressed by the Commission on similar prior proposals, are discussed below.

A. Decreasing the filing period for beneficial ownership reports

One widely discussed issue is the proposal to reduce the filing period for initial beneficial ownership reports provided in Section 13(d)(1) of the Securities Exchange Act. 10/ Section 13(d)(1) requires persons who acquire beneficial ownership of more than five percent of a class of equity securities in a company to notify the issuer, each exchange on which the security is traded, and the Commission of certain specified information. 11/ The purpose of Section 13(d) is to provide adequate

10/ S. 78, S. 227, S. 521, S. 336, S. 634, and S. 678 all contain provisions for reducing this period to either two days or 24 hours. Some of the bills have proposed additional modifications including requiring purchasers to make a public announcement, requiring them to suspend (or giving the Commission authority to require them to suspend) purchases for a specific period of time, and reducing the threshold ownership level that triggers the filing requirement.

11/ This information includes (1) the title and class of the security and the name and address of the issuer; (2) the identity and certain background information on the purchaser; (3) the source and amount of funds or other consideration used in making the purchase; (4) the purpose of

(footnote continued)

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disclosure to investors of acquisitions that might lead to a change in control of the company.

The present statute gives the acquiring shareholder ten days after crossing the 5% threshold within which to submit the required information, allowing the purchaser to acquire additional shares within that period prior to making any disclosure. In some situations, the ten day filing period has enabled persons to acquire substantial positions prior to disclosure. In extreme situations, as much as 20 percent of a company's securities has been acquired before the ten day period has elapsed.

Supporters of legislation argue that it is necessary to close this "ten day window" in order to effectuate the basic disclosure policy of the Williams Act. Opponents of the change argue that earlier disclosure raises the cost, and thus discourages the acquisition of substantial positions by potential bidders.

11/ (Continued)

the acquisition; (5) the aggregate number and the percentage of the class of securities owned by the purchaser; and (6) a description of any contracts, arrangements, understandings or relationships regarding the securities of the issuer. Section 13(d)(2) requires persons who filed, pursuant to 13(d)(1), to promptly amend their filing in the event of a material change in this information. Pending proposals would not alter this requirement.

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The Commission has favored shortening the ten day filing period. In 1984, the Commission proposed legislation that would have provided the Commission with authority to require immediate public announcement of a triggering acquisition, to specify the time for filing a statement, and to specify a length of time, not to exceed two business days, during which no additional purchases could be made. At its May 1985 meeting the Commission determined to repropose this legislation. In its January 9, 1986 open meeting the Commission decided to change its proposal to simply reduce the filing period required by the Act from ten days to two days, and in March 1986 the Commission submitted this new legislative proposal to Congress.

B. Issuer Targeted Repurchase Programs

Another issue is whether the practice commonly known as "greenmail" should be prohibited by federal law. ^{12/} "Greenmail" refers to the practice where an issuer selectively repurchases a block of shares from a shareholder or group of shareholders, generally at a premium over the market value of the stock.

^{12/} S. 78, S. 227 and S. 521 would prohibit issuers from repurchasing shares at a premium from shareholders who have held a certain percentage of the corporation's shares for less than a specified period of time. S. 634 would impose an 80 percent excise tax on such payments if there has been a tender offer or a proposal or plan to make a tender offer for the issuer within the one year period prior to the payment.

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"Greenmail" may be used by target company management as a means to eliminate a threatened hostile takeover attempt or to remove dissident shareholders.

The proponents of legislation offer a variety of reasons in favor of prohibiting the practice. A common argument is that "greenmail" represents a payment for the value of control of the corporation and as such should be distributed equally among the shareholders. It is also argued that such payments can constitute a waste of corporate assets purely for the benefit of a single shareholder. Proponents also urge that such payments encourage hostile tender offers by persons with no real intent to acquire the issuer. Such payments, the proponents argue, can financially weaken companies by forcing them to take on additional debt to buy out the shareholder.

Most opponents of such legislation, while agreeing with the reasons for disfavoring the practice, argue that "greenmail" is more effectively and appropriately controlled in other ways (e.g., by refusal of corporate management to be "greenmailed," by the adoption of corporate charter amendments, or by shareholder suits). They argue that federal action in this area is an inappropriate encroachment of the federal government into an area traditionally governed by state law under the "business judgment rule." Some opponents of legislation also argue that "greenmail" can serve a useful purpose because it reduces the cost associated with a failed takeover attempt,

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thereby encouraging legitimate takeover efforts in marginal cases.

The Tender Offer Advisory Committee recommended anti-"greenmail" legislation in 1983. The Commission's 1984 legislative proposal contained a provision that would have prohibited issuers from repurchasing their securities at a premium to their market value from persons who had held more than 3% of the class of securities for less than two years unless the issuer made a similar offer to all holders of the class of securities, or had prior shareholder approval.

The Commission withdrew its support for this proposal in May 1985 and affirmed this decision in January 1986. The Commission based its determination that legislation was no longer necessary or appropriate on the conclusion that direct economic consequences to the paying corporation, market forces, state actions, shareholder litigation and changes in the tax laws were all serving to control "greenmail." In particular, the Commission noted that shareholders were pursuing litigation against companies that pay "greenmail," that companies were adopting anti-"greenmail" amendments to their charters, 13/ and that companies that did make "greenmail" payments found that paying one group often led to demands for payments from others.

13/ A study in February 1987 by the Investor Responsibility Research Center showed that between 1984 and 1986 approximately 70 companies adopted anti-"greenmail" charter provisions.

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The Commission also noted that the Deficit Reduction Act of 1984 had made "greenmail" less profitable to the recipient. ^{14/} Recently, there have been a number of highly publicized incidents involving repurchases of large blocks of shares from particular shareholders. ^{15/} The Commission intends to reexamine the "greenmail" issue in light of these events in order to assess whether a federal regulatory response is necessary.

C. Modification of Minimum Offering Period
for Tender Offers

At present, tender offerors are required to hold their tender offers open for at least twenty business days from the date when the offer is first published, sent or given to security holders. If the percentage of securities sought or the consideration offered is either increased or decreased, the offer must remain open for an additional ten business days. The offering period must also be extended following material changes in the terms of the offer or information concerning the

^{14/} Prior to the enactment of the Deficit Reduction Act ("DRA") a corporation could deduct both the interest paid on a loan used to obtain a "toe-hold" position in a company and 85% of any dividends received from the target from its tax liability. Under the DRA, the 85% corporate dividends deduction is reduced by a percentage related to the amount of debt incurred to purchase the stock, making the tax benefits of acquiring a toe-hold position less attractive.

^{15/} Examples of such controversial repurchases include: Good-year Corporation's repurchase of shares held by Sir James Goldsmith, CPC International's repurchase of shares from Ronald Perelman, and repurchases by USG Corp., Ashland Oil and Potlatch Corp. of shares held by the Belzberg family.

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offer; in those cases the minimum extension period will depend on the facts and circumstances, including the relative materiality of the terms or the information. As a general rule, the Commission is of the view that the offer should remain open for a minimum of five days from the publication of the material new terms or information.

Proponents of legislation to extend the minimum offering period 16/ argue that the extension would benefit both shareholders and the boards of directors of target companies by giving them time to evaluate fully and respond to a tender offer. With respect to shareholders' need for additional time they contend that the present twenty business day period (approximately 28 calendar days) is not sufficiently long to allow non-professional shareholders to fully understand the information disclosed to them, particularly in cases where more than one bid is involved. With respect to target managements' need for additional time, it is suggested that the additional time would balance the "element of surprise" which favors the bidder and would allow management more time to develop responses to the bid, and to solicit competing bids. It is further argued that the present twenty business day period encourages

16/ S. 521 would extend the minimum offering period from 20 to 45 business days. S. 678 would extend the period to 60 days. S. 227 would set different offering periods for initial and subsequent offers and have those periods vary depending on whether the offer is for all shares or is a partial or two-tier offer.

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target management to adopt defensive tactics, which may not be in the overall best interests of the corporation, solely for the purpose of "buying time."

Opponents of the legislation argue that it is inappropriate to enact legislation that favors target management at the expense of offerors, and that extending the time period discourages justifiable takeover attempts by increasing the costs of the offer both to bidders and to tendering shareholders.

The policies underlying the Commission's position in this area and the overall federal scheme for regulating tender offers are two-fold. First, the Commission has supported the view that the regulatory scheme should not favor either bidders or targets in a contest for corporate control. Second, the Commission has supported the achievement of investor protection primarily by ensuring full disclosure of material information and a sufficient opportunity to review this information so that the disclosure is effective. The Commission's position has been that in order to effectuate both of these policies, the minimum offering period should strike a balance between maintaining neutrality and providing sufficient time for the tender offer to be published and for shareholders to receive, digest and respond to the offer, while favoring neither bidders nor targets.

The Commission arrived at the present twenty business day period in 1979 after three years of public comment and analysis. The Commission submitted two separate proposals on this issue for public comment and received over 200 letters in response.

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The comment letters reflected widely divergent views on this issue. While most of the commentators favored the institution of a minimum period in excess of the ten day period implicit in the operation of the statute, there was no consensus as to what the appropriate length should be. The Commission was persuaded by the views of commentators who indicated that a minimum of thirty business days was unnecessarily long. The Commission was of the view that the objectives of a minimum offering period could be accomplished with a minimum period of twenty business days.

The Commission reaffirmed this view in January 1986 in determining to apply to issuer tender offers the same twenty business day minimum offering period that applies to third party tender offers.

D. Partial and Two-Tier Offers

Legislation has also been introduced that would limit the use of partial 17/ and two-tier tender offers. 18/ Some of the

17/ A "partial" offer is a tender offer for less than 100% of the outstanding shares of a class of securities.

18/ A "two-tier" bid involves an acquisition of all outstanding shares that is accomplished in two steps. In the first step, the bidder uses a tender offer to buy a controlling position in the target. Once control is established, the offeror will engage in a second step business combination, usually a merger, taking out the minority shareholders with consideration frequently valued at a lower price than the original tender offer price.

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proposed methods for achieving these goals include extending the offering period for those specific types of offers, 19/ prohibiting any tender offer that would result in ownership of a substantial percentage of shares unless the offer is for all of the shares, 20/ and prohibiting any substantial purchases unless they are made by means of a tender offer. 21/ Persons favoring controls on partial and two-tier offers argue that these offers coerce shareholders by creating a "stampede" effect among shareholders. Shareholders may feel compelled to tender as quickly as possible in order to avoid losing the premium and, in the case of two-tier offers, in order to avoid being forced to accept a lower premium at a later time.

Opponents of legislation to limit partial tender offers argue that there are legitimate reasons for obtaining a substantial share of a company without purchasing all shares, and that these purchases would be discouraged. Opponents of legislation to limit two-tier offers argue that a bidder may be able to acquire control of a company, using a two-tier bid, at a lower cost to the bidder, while offering a premium comparable to that in an offer for all of the shares. Thus bidders may make two-tier tender offers where otherwise no bids would be made, and prohibiting such offers would deter legitimate, valuable

19/ S. 227.

20/ S. 634.

21/ S. 678.

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takeovers. It is also argued that two-tier offers give small buyers needed flexibility, by spreading the cost of a takeover attempt over a longer period of time. Such offers make it possible for small bidders to make valuable acquisitions. Opponents also argue that there is no need for a federal response to two-tier offers because issuers are free to adopt "fair price" charter provisions requiring that the price paid in a second step merger equal or exceed by some percentage the price paid in the first stage tender offer. Finally, the differential between the consideration offered in the first and second tiers in a correctly structured two-tier offer may not be as significant as the absolute dollar values of the tiers might suggest. Shareholders who sell their shares for cash must recognize their gain at the time of the sale for the purposes of federal tax law. ^{22/} Shareholders who exchange their stock in the target corporation for voting stock in the acquiring corporation in a merger that qualifies as a tax-exempt "reorganization" under the Internal Revenue Code may not be required to recognize any gain at the time of the exchange. ^{23/} Differing tax treatment of the gain to shareholders in the two tiers of a two-tier acquisition may alter the shareholders' valuation of the consideration offered.

^{22/} See Internal Revenue Code §§ 61(a)(3), 1221.

^{23/} See Internal Revenue Code §§ 354, 368.

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In its January 1986 open meeting the Commission specifically considered whether it should take action to limit partial or two-tier tender offers and determined that such action was unnecessary. The Commission had previously taken the position that it is not desirable to discourage partial tender offers, because there are many sound and practical justifications for partial acquisitions: they allow one company to invest in another with less than 100% financial exposure; they facilitate technological changes and relationships; they facilitate venture capital, foreign and other direct investments; and they permit investors to become familiar with potential acquisitions before deciding to increase their investment.

The Commission had also noted that two-tier offers provide substantial premiums to shareholders. A study by the Commission's Office of the Chief Economist in 1985 showed that between 1981 and 1984 the average initial bid in a two-tier offer was made at a 63% premium over the prior market price of the stock, and that the second step merger was, on average, at a 45% premium to the market price. The resulting average blended premium was approximately 55%. During the same period, the average premium for any-or-all offers was approximately 60%. 24/

In addition, the Commission concluded that no action was necessary against two-tier offers based on evidence that the

24/ See The Economics of Any or All, and Two-Tier Tender Offers (April 19, 1985) (study by the Commission's Office of the Chief Economist of 228 tender offers between 1981 and 1984).

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use of two-tier offers appeared to be waning without any federal intervention: In fiscal year 1982, 18% of all offers were two-tier offers; in FY 1983, 26% were two-tier offers; in FY 1984, 12% were two-tier offers. In FY 1985 and in FY 1986 three percent were two-tier offers. 25/

E. Prohibition of Substantial Acquisitions
Except by Tender Offer

It has also been proposed that shareholders with a substantial position in a company's stock be prohibited from making any further significant acquisitions except by means of a tender offer. 26/ Proponents of such legislation argue that a person who acquires corporate control through gradual acquisitions may do so without ever having paid the substantial premium usually associated with such control, thus obtaining a valuable corporate asset without paying for it. It is further argued

25/ For the purpose of compiling this information, an offer was classified as "two-tier" if, at the time of the initial offer, the bidding firm disclosed an intent to purchase more shares at a specific consideration following the execution of the first-tier offer.

26/ S. 227 would prohibit holders of 20% of a class of a company's shares from acquiring more than an additional 2% in any single calendar year except by tender offer. S. 678 would prohibit acquisitions which would make a person the beneficial owner of 15-35% of a company's shares unless made by tender offer, and would prohibit purchases which would make the acquirer the beneficial owner of more than 35% of a company's shares except by tender offer for all shares in the class or by a partial offer with an agreement to purchase the remaining shares within 6 months at a value equal to the tender offer price. The provisions of S. 678 that effectively prohibit partial tender offers are addressed in the previous section.

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that even if the purchaser does pay a premium, when control is obtained through open market or privately negotiated purchases, smaller shareholders have no opportunity to participate in that premium for control. It has also been suggested that such proposals would address issues raised by recent judicial decisions declining to hold that substantial purchases during the course of or immediately following the termination of a tender offer constituted "unconventional tender offers" governed by the Williams Act. 27/

The proposed amendments would represent a significant departure from the present regulatory scheme and therefore raise substantial questions about the appropriate nature and scope of federal tender offer regulation. The Commission has previously expressed the opinion that it has generally found the statute is sufficiently flexible to deal with novel and innovative tender offer practices, and believes that the principles underlying its regulatory scheme remain sound. 28/ The Williams Act was not designed to direct the manner in which transfers of corporate control were to be achieved. With respect to purchases made other than by tender offer, the federal scheme was intended to provide full and timely disclosure. The broader,

27/ See Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985); SEC v. Carter Hawley Hale Stores, Inc., 760 F.2d 945 (9th Cir. 1985).

28/ Securities and Exchange Commission Response to Congressman Wirth's Letter of January 25, 1985 Concerning Tender Offers, at 4 (August 22, 1985).

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more pervasive scheme for the regulation of tender offers was designed to provide additional protections to shareholders of corporations subject to tender offers, by ensuring that they received full and fair disclosure and by providing them with an opportunity to examine and assess the relevant facts without undue pressure.

Opponents argue that requiring that all substantial acquisitions be made by tender offer would have important practical consequences. Such a requirement could impose additional significant costs on both purchasers and sellers of blocks of shares, regardless of whether any change of control was involved. They urge that purchasers could be constrained from employing more suitable alternative methods for structuring purchases. They further argue that shareholders with large blocks of shares could be denied the opportunity to liquidate their holdings except by selling them on the open market, which may have the effect of depressing the value of the stock overall, while simultaneously denying the shareholder any control premium that the block might otherwise command.

It is also argued that the proposed legislation could increase the cost to bidders of acquiring an initial position in the stock of a target and thereby discourage some bidders from making offers for some companies; while shareholders of companies subject to bids may benefit, shareholders of companies on which bids are not made may lose. It is argued that as a

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result, the viability of takeovers as a disciplinary force on the market could be reduced.

Insofar as the proposed legislation reflects concerns about recent court actions narrowly construing what constitutes an "unconventional tender offer" that must be made in compliance with the Williams Act, the Commission has shared these concerns. In its July 31, 1986 concept release, the Commission sought comment on whether regulatory action was necessary to assure that substantial purchases during the course of or immediately following the termination of a tender offer were made in compliance with the Williams Act. Such a requirement would prevent buyers from using the circumstances created by a pre-existing tender offer to acquire control of a company where, absent the preexisting tender offer, the acquisition would not have been possible except by means of a conventional tender offer. Such a requirement also would respond to concerns that the present regulatory scheme may encourage bidders to put a company "in play" by making a tender offer, only to bypass the Williams Act by terminating the offer and buying from the market professionals, and also to concerns that issuers and their "white knights" can defeat tender offers by buying from the market professionals during the tender offer while the original offeror is prohibited from making such purchases. This type of regulation would not, however, have the same ramifications for other types of open market and privately negotiated transactions as could be anticipated from the proposed legislation.

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F. Prohibition of Certain Compensation Packages

There is also support for prohibiting issuers from increasing the compensation of their officers and directors after a tender offer has been initiated. ^{29/} Proponents of this type of legislation argue that the adoption of extraordinary compensation packages, known as "golden parachutes," following the commencement of a tender offer presents, at a minimum, the appearance of self-dealing on the part of management. They argue further that such arrangements may create a potential for a conflict of interest if these provisions interfere with management's ability to make a disinterested evaluation of whether an offer is in the best interest of the shareholders.

Opponents of legislation in this area argue that federal regulation of contracts between companies and their officers and directors would constitute an inappropriate preemption of state law. Decisions regarding the use of corporate assets have been traditionally left to the states for resolution under the "business judgment rule." Opponents argue that federal intervention is not justified simply by the fact that these particular contracts are entered into in response to a threatened corporate takeover. It is also argued that arrangements for compensation in the event of a change of corporate control

^{29/} S. 227 would prohibit issuers from entering into agreements increasing compensation for management, other than in the ordinary course of business, once a tender offer has commenced. S. 634 would also increase the excise tax on extraordinary compensation resulting from a change in control from 20% to 50%.

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usually represent a small fraction of an acquisition price and that these compensation packages can assist an issuer's efforts to attract and retain high quality management, may help keep management's attention focused on running the business by limiting their concerns about their own futures, and serve to align management's interests more closely with those of shareholders when an offer for the company is at hand.

Another argument against the proposal is that it would have limited application in any event because its adoption would simply accelerate the present trend of adopting "golden parachute" provisions before a tender offer is even threatened. Recent studies show that corporations are no longer waiting for the threat of a tender offer to materialize to implement change of control compensation. In April 1986, 387 of the "Standard & Poor's 500" companies had agreements or policies providing for such compensation. Forty percent of the "Fortune 500" companies have similar provisions in place. ^{30/}

The Tender Offer Advisory Committee recommended prohibiting issuers from entering into contracts or agreements with their officers and directors for increased compensation other than

^{30/} The proposed legislation would also not address the recent development of the "tin parachute," which is a plan providing that a wide range of employees not previously covered under "golden parachute" plans may become entitled to cash payments if control of the company changes hands against the wishes of the directors. It has been asserted that these compensation arrangements may represent a greater deterrent to hostile takeovers than do "golden parachutes" because of their cost to the potential bidder.

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in the ordinary course of business after a tender offer has commenced. The Commission included such a proposal in its 1984 legislative package. The Commission withdrew its support for the proposal in 1985 because the changes in taxation of "golden parachutes" 31/ and the availability of remedies under state law led it to conclude that there was insufficient justification to preempt state law in this area. The Commission reconsidered this issue at its January 1986 meeting and arrived at the same conclusion.

G. Restriction of Defensive Target Responses

There have also been a number of proposals to restrict the ability of target corporations to undertake extraordinary restructuring in order to defeat or deter a tender offer. These proposals are directed at two types of practices: the acquisition or disposition of significant corporate assets, practices commonly referred to as "show stoppers" and selling the "crown jewels," and the issuance or redemption of securities with extraordinary rights commonly referred to "poison pills." 32/

31/ The Deficit Reduction Act of 1984 ("DRA") denies employers deductions for certain "excess parachute" payments and requires recipients to pay a 20% excise tax.

32/ S. 634 would prohibit issuers, during the pendency of a tender offer, from issuing securities with exceptional voting rights, dividend rights or rights to the receipt of specified assets which become effective on a change of control. The bill would also prohibit issuers from disposing of corporate assets on the occurrence of a change in control. S. 678 contains similar provisions. It also would prohibit any acquisition of a significant amount of assets other than in the ordinary course of business after a takeover bid has been announced.

Proponents of legislation prohibiting the use of these types of defensive practices argue that they have no legitimate purpose other than substantially to increase the cost of a tender offer or to make it less attractive to the bidder. It is argued that these types of provisions serve only to skew the proper valuation of the target and thus to deprive shareholders of potentially advantageous tender offers.

Opponents argue that these types of plans are beneficial because they serve to place control over the success of a tender offer into the hands of target management. The target management can use such strategies to block a proposed tender offer to get the best possible offer for shareholders in a situation where individual shareholders could be coerced into accepting lower prices. It is further argued that potential abuses in the exercise of target management's authority to manage the corporation's assets are adequately and appropriately controlled by shareholder actions both in state court and through the mechanism of shareholder voting.

The Tender Offer Advisory Committee recommended against legislation that would have limited the ability of target companies to make significant asset sales during the course of a tender offer. The Advisory Committee concluded that asset dispositions may be a legitimate part of a plan to realize value for shareholders in excess of a proposed bid. The Commission supported the proposition that state corporation law should govern the disposition of assets during a tender offer.

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The Commission's 1984 legislative proposal did include a provision that would have prohibited certain acquisitions of an issuer's own securities during a tender offer and would also have limited certain grants of substantial voting powers or issuances of substantial quantities of securities during the course of a tender offer. Although the Commission determined not to repropose these items as part of its legislative package, it remained concerned about the possibility that target management may abuse its authority in this area. The Commission, in its July 1986 concept release, sought comment on whether a regulatory response to the increased use of "poison pills" would be appropriate.

* * * *

The Commission appreciates this opportunity to testify and will be pleased to provide the Subcommittee any assistance in its inquiry into the adequacy of existing law.

Senator METZENBAUM. Our next panel consists of Boone Pickens, author; Robert Mercer, Chairman and Chief Executive Officer of Goodyear Tire & Rubber Company; and Milan Stone, President of the United Rubber Workers.

While Mr. Pickens is coming to the table, we are very happy to hear from you, Mr. Mercer. It is nice to see you here, one of my constituents, and I know you have gone through the mill on this question and we are happy to receive you, sir.

STATEMENT OF A PANEL CONSISTING OF ROBERT E. MERCER, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, GOODYEAR TIRE & RUBBER CO.; MILAN STONE, PRESIDENT, UNITED RUBBER WORKERS INTERNATIONAL UNION; AND T. BOONE PICKENS, JR., GENERAL PARTNER, MESA LIMITED PARTNERSHIP

Mr. MERCER. Thank you, Mr. Chairman and members of the Subcommittee. I am Robert Mercer, Chairman and Chief Executive Officer of the Goodyear Tire & Rubber Co., and I appreciate this opportunity to contribute to your efforts to bring some order and discipline to the hostile takeover activity which is sapping the vitality and infrastructure of American industry.

As you know, Goodyear was the target of a takeover attack last fall. We successfully resisted the attack in the conviction that it was in the best interests of our customers, of our shareholders, our employees, the communities in which we operate and, of course, our vendors and other constituencies.

But we paid a stiff price in people and jobs, and for approximately 3 years will be hampered in making the level of investment in plant, training and research and development required to remain number one in global competition in the future. Only by virtue of our past investments in these areas will we be able to bridge this gap.

The extent of restructuring required because of the takeover attempt includes sale of three subsidiaries, closing of three plants, reduction of employment by 4,000 jobs, and the assumption of \$4 billion in debt, which will leverage Goodyear to 80 percent of debt to total capitalization.

This subcommittee might well observe, well, after all, Goodyear emerged with its core businesses in tires and general rubber products intact. Is its future all that much affected?

Well, I could give you only hypothetical answers on what we might have been able to contribute to future growth and employment had we not been attacked. However, I can offer you perspective by describing some of the investments we would not have made if the attack had come several years earlier. So let me give you some examples, starting in the late 1970s.

In 1977, to assure Goodyear's future competitive position in world auto tire markets, we invested \$216 million in a new, advanced radial tire plant in Lawton, Oklahoma, which now employs 1,970 people. We could not have made this investment.

The following year, we invested \$80 million to build a new radial auto tire facility adjacent to an older bias tire plant in Gadsden, Alabama. We could not have made this investment. In total, the Gadsden operations today employ more than 3,000 people and we

are planning to modernize the entire complex to assure its future rule in global competition.

In 1982, to stay competitive in the air springs business, we invested \$9 million to build a new plant now employing 225 people at Greensburg, near Canton, Ohio. We would not have made that investment.

In 1983, we invested \$250 million to convert a bias tire plant at Tyler, Texas, to a modern, world competitive radial auto tire facility, which just last month celebrated the attainment of a 25,000-tires-a-day pace. We could not have made that investment.

And add to this the \$14 million invested in Freeport, Illinois, to make us globally competitive in the farm tire market—another investment we could not have made.

In 1985, we invested \$5 million in our Auburn, Pennsylvania, film laminates plant to keep it competitive. This plant employs 238 people. Had there been a takeover defense in our history in 1985, we would not have made that investment in a relatively small operation.

These and similar investments are what make it possible for our plants to hold their own in global competition. For example, in many foreign countries it takes from 25 to 50 man-minutes to manufacture a 13-inch tire. Our modern U.S. plants do it in less than 10 man-minutes. The investments we have made in advanced technology and equipment enables us to support higher American wages and benefits, which amount to more than \$20 an hour, versus as low as \$1.60 in Korea.

Add to that investment the commitment of a dedicated U.S. workforce, aided by the leadership of Mike Stone, International President of the URW. They have a stake in this, too.

Because of our restructuring, some of our past investments will now be paying off for other companies and other shareholders. A case in point is our former aerospace subsidiary, now part of the Loral Corporation. While we believe the new owners will do well for our former subsidiary and its 8,400 employees in Akron, Ohio, Litchfield Park, Arizona, and Rockmart, Georgia, investments we have made in that operation since its formation in 1911 no longer figure in our present or future business. Other investments and the jobs associated with them will simply disappear as competitors move into the marketplace, and largely from overseas.

The ravages of the virtually unbridled activity of corporate raiders is becoming all too apparent—healthy corporations broken up in takeovers, more often than not financed through the sale of their own assets; thousands upon thousands of jobs destroyed; erosion of the industrial base and tax base in hundreds of communities; a climate of fear in which diversification or any degree of long-term investment are an open invitation to a raid; mortgaging of America's competitive future for the quick gratification of raiders and their camp followers, the arbitrageurs.

As they stalk their targets, the raiders almost invariably scribe incumbent managements as entrenched, obsessed with and privilege. Now, I have reviewed my perks and find the board allows me one, and that is free and unlimited use office on nights and weekends.

Now, any attempt at diversification or planning or investment for results beyond the next quarter comes out as poor management. For their own activities, their greed, the raiders reserve such euphemisms as helping their prey get back in focus, enhancing shareholder value, and protecting shareholders' rights.

So I have one question for the raiders. If unsolicited, hostile takeovers are all that good for American industry, the economy and our nation's competitive future, which they are not, why must you slip through loopholes in our laws, conduct your approach in stealth and subterfuge, and take your targets, their employees and their classic shareholders by surprise?

If stealth and subterfuge are not essential to the activities of raiders, then I apologize, and I suggest they then should have no problem with the six recommendations that I am about to make.

The first is to require filing of a 13(d) with the SEC within 1 day after an individual or group acquires two percent of a company's stock. Second, I recommend extending the minimum time period for a tender offer from the present 20 days to 60 days. A change in control of a corporation involves complex issues, including determination of the corporate value, and neither boards of directors nor shareholders should be stampeded into hasty decisions, notwithstanding the desire for speed on the part of the raiders, arbitrageurs, and the investment bankers.

Third, prohibit greenmail. Payment of greenmail does not treat all shareholders equally and its possible availability encourages those raiders who want to take their money and run.

Now, Goodyear faced that choice and we spent \$2 billion to give shareholders a better deal than the raider got. As a result, the raider left \$72 million on the table running off with \$94 million in his pocket.

Fourth, outlaw the two-tiered and partial tenders. Like greenmail, they are not fair to all shareholders and they help turn what should be a rational, studied consideration into a stampede.

Fifth, limit such practices as sweeping the street and creeping tenders. Chairman Metzenbaum, your proposal in this area moves in the right direction for getting at these harmful open-market abuses.

And, sixth, close the partnership loophole in the Hart-Scott-Rodino law through which raiders slip by organizing as partnerships whose assets do not have to be counted, thus escaping the obligation to file with the Federal Trade Commission and Justice Department for purposes of antitrust review.

I would be remiss not to note that such a proposal was approved by this subcommittee on March 19, and I commend you, Mr. Chairman and members of the subcommittee, for your attention to a flaw which puts America's public corporations at a tremendous disadvantage against the raiders.

Finally, let me say that, in my opinion, none of these proposals should interfere with friendly mergers or acquisitions, nor with hostile takeovers conducted on an open, straightforward basis with the true interests of all shareholders in mind.

Thank you for inviting me to state my views.

Senator METZENBAUM. Thank you, Mr. Mercer.

There will be a 2-minute recess. I have another committee hearing and I will be right back.

[Recess.]

Senator METZENBAUM. The hearing will come to order. Senator Simon, we are happy to welcome you.

Will those who are standing in the aisles talking be good enough to leave or be seated?

Mr. Stone.

Mr. STONE. Mr. Chairman and members of the Senate Antitrust, Monopolies, and Business Rights Subcommittee, my name is Milan Stone. I am the International President of the United Rubber Workers Union. We represent approximately 110,000 workers across the United States and Canada. Our union is headquartered in Akron, Ohio.

I will present a condensed version of my remarks. I would request that the entire text be entered in the record, Mr. Chairman.

Senator METZENBAUM. Without objection, so ordered.

Mr. STONE. I want to thank this Subcommittee for scheduling this important hearing. I especially want to commend you, Senator Metzenbaum, for your demonstrated leadership on this extremely critical issue.

Senator METZENBAUM. Thank you.

Mr. STONE. The rubber workers have had some recent firsthand experience with hostile takeovers. Goodyear was the target of Sir James Goldsmith just 6 months ago. Firestone, Goodrich and Uniroyal were all involved with Carl Icahn at some point over the last several years, and only a couple of weeks ago GenCorp was hit with a hostile takeover attempt by a partnership affiliated with AFG Industries and Wagner and Brown.

It is too early to determine what will happen with the GenCorp attempt. However, it is a certainty that GenCorp will be a different company in the future. Whether it is restructured or dismembered, jobs will likely be lost.

I would like to focus my remarks this morning on the aftermath from the URW's perspective of the attempted takeover of Goodyear Tire and Rubber where we represent about 25,000 workers.

As you know, to fend off Goldsmith's takeover attempt, Goodyear is restructuring itself. As part of that program, Goodyear has already announced the closing of three of its plants and has recently said it may close more.

So far, nearly 3,000 URW members are going to lose their jobs, along with some 1,800 salaried personnel whose jobs have also been eliminated.

Let me give you an example of what a plant closure means. In Cumberland, Maryland, over 1,000 rubber workers, members of Local 26, are losing their jobs. Our members in that plant make tires and earn an average of \$11.72 per hour. Some \$25 million of wages a year will be directly taken out of the Cumberland economy.

Manufacturing wages generally multiply six or seven times through the economy, which means that the loss of the Cumberland jobs could cost the local economy \$175 million annually. This estimate considerably understates the impact, however, because it does not include the loss of 600 white-collar jobs. Cumberland is not

a big town and a loss of this magnitude will create serious problems for the community.

The other communities affected by Goodyear's restructuring face a similar scenario. One of the plants that is closing is in Toronto, Canada. Nevertheless, it is affected by the restructuring a U.S.-based company and its workers are our members. The impact on those workers is certainly just as real as the impact on those in Cumberland, Maryland.

People are our bottom line. Where will these people and possibly many others find new jobs? The statistics indicate that getting a new job in this country is often a lengthy process and that, in most cases, the new job offers less in wages and benefits than the old one. Consequently, the workers' standard of living is lowered.

Businesses in the affected community stand to lose as their customers now spend less. The tax base of the community and the public services it is able to offer are likely to be cut.

This is all part of a negative or a reverse multiplier effect that ripples through the economy and touches the lives of many not directly associated with a plant closure or massive lay-off.

However, the human costs of plant closures, and indeed forced unemployment for whatever reason, are even more alarming and represent an even more terrible waste, the waste of our nation's most valuable resource, its people.

A definite relationship between unemployment and physical and mental illness has been documented. According to the Institute for Social Research at the University of Michigan, plant closings are accompanied by increased incidents of arthritis, high blood pressure, and ulcers among terminated workers.

Psychologists and social workers have found noticeable increases in divorce, alcoholism, child beating, depression, drug abuse, suicide, criminal behavior and poor mental health among the unemployed.

Dr. M. Harvey Brenner of Johns Hopkins University prepared a study in 1984 for the use of the Joint Economic Committee of the U.S. Congress, titled "Estimating the Effects of Economic Change on National Health and Social Well-Being."

Among the many statistics generated from Dr. Brenner's investigation is one which shows that among those who are forced into unemployment through the closing of a plant, the suicide rate is 30 times higher than that of the rest of the population.

In a takeover battle, workers, customers and the community are ultimately the losers. Workers often finance the cost of a raid by job losses or pay cuts. Even workers who may keep their jobs for now pay the price of job insecurity and run the very real risk of losing those jobs later on as the company finds itself becoming less competitive in the future because it has had to cut back on research and development to bolster immediate profits.

In my opinion, there is something inherently wrong with our system when it allows this kind of corporate extortion. A business should be able to operate to benefit its customers, its owners, its employees, and its community, not the corporate raider who generally knows little about the company he is raiding or the industry in which that company operates and who does not seem to care what

hardship his tactics may bring to the people who work for the target company and to the community at large.

We are asking the Congress for help in restructuring our laws so they do not allow the dangerous speculative excesses that feed the takeover epidemic. We see the following as steps that can afford protection to workers involved and ultimately our members.

Number one, greenmail should be prohibited. Our securities laws should be examined with an eye toward stopping hostile takeovers.

Senator METZENBAUM. Can you wind up, Mr. Stone? We have a roll call vote on.

Mr. STONE. Yes.

Laws regulating banks and investment companies should prohibit involvement. And, four, mechanisms should be developed to require compulsory successor clauses and the takeover should operate that plant in its present form for 3 years.

I cannot stress strongly enough the importance of what your Committee is doing, Senator Metzenbaum. I am very concerned that our ability to remain a major world economic power is being compromised and damaged beyond repair.

Thank you very much.

[Submissions of Mr. Stone follow:]

Statement of
MILAN STONE
President, United Rubber Workers International Union
to the
Antitrust, Monopolies & Business Rights Subcommittee
Judiciary Committee
U. S. Senate
Washington, D. C.
on
Hostile Corporate Takeovers
April 2, 1987

Summary of Prepared Testimony

The United Rubber Workers view Corporate Takeovers as a method to make enormous profits for the already rich without creating anything new in the way of jobs, products or enhanced competitiveness. Corporate takeovers are "sterile transactions" which penalize companies which pursue their long-term competitiveness by forcing them to concentrate unduly on the short term. Spread throughout the industrial base, such efforts, unrestrained, are a certain prescription for economic ruin in view of the worldwide competition the United States now faces.

In a takeover battle, workers, customers and the community are ultimately the biggest losers as plants close, layoffs are increased and pay is cut.

Last November, Goodyear Tire & Rubber Company was the target of a hostile takeover attempt by Sir James Goldsmith. The attempt did not succeed, but Goodyear was forced to undertake a restructuring program which has 1) thus far resulted in three plant closures, numerous layoffs and instances of contract concessions, 2) left Goodyear with \$4 billion in debt, 3) cut research and development, 4) cut capital expenditures, and 5) meant the sale of some Goodyear subsidiaries. While Goldsmith walked away with over \$100 million for his unwanted and unwarranted efforts, thousands of Goodyear's employees will suffer considerable hardship, as will the communities where Goodyear closed plants. The economic cost to these people and their communities will total much more than the \$100 million Goldsmith made in his paper transactions.....the human cost cannot be measured.

Something must be done to correct a system which allows the kind of extortion that we call a corporate takeover. The following are steps that must be taken to stop the takeover epidemic: 1) greenmail should be prohibited; 2) securities laws should be strengthened to stop hostile takeovers; 3) banks and investment companies should be prohibited from involvement in a hostile takeover; 4) develop protective measures for affected workers and communities to include requiring anyone who gains control through a hostile takeover to operate the corporation in its form at the time of its takeover for three years.

Statement of
MILAN STONE
President, United Rubber Workers International Union
to the
Antitrust, Monopolies & Business Rights Subcommittee
Judiciary Committee
U. S. Senate
Washington, D. C.
on
Hostile Corporate Takeovers
April 2, 1987

Mr. Chairman and Members of the Senate Antitrust, Monopolies and Business Rights Subcommittee:

My name is Milan Stone. I am President of the United Rubber Workers International Union. We represent approximately 110,000 workers across the United States and Canada. The URW is headquartered in Akron, Ohio where it was founded 51 years ago.

I want to thank this Subcommittee for scheduling this important hearing. I especially want to commend you, Senator Metzenbaum, for your demonstrated leadership on this extremely critical issue.

The Rubber Workers have had some recent first-hand experience with hostile takeovers. In view of that experience, I would like to provide you with the URW's perspective on this issue, particularly as it relates to The Goodyear Tire and Rubber Company where we represent some 25,000 workers. As you know, Goodyear fought off a hostile takeover attempt by Sir James Goldsmith late last year. Part of this statement is devoted to the costs of that somewhat Pyrrhic victory.

However, I do not want to deal solely with that particular unwanted and unwarranted advance. The issue is much deeper and far broader than a single company or a single corporate raider. It is a problem that has grown in magnitude and scope to the point that the economic health of the entire United States is quite literally threatened. Every day, newspapers are filled with stories about these nonproductive attacks against major profitable companies.

In his opening statement at a hearing held January 28th by the Senate Banking Committee, Senator William Proxmire estimated that in 1986, the total cost of acquisitions--\$150 billion--exceeded by \$10 billion the amount American manufacturers spent on plant and equipment. To me, that sounds like a prescription for economic ruin.

The billions of dollars used to finance, as well as fend off, hostile takeovers is money that is consequently not available for investment in strengthening the U. S. economy. The money, time, effort and imagination that corporate managers are forced to devote to fighting takeover battles is money, time, effort and imagination that would be far better spent in manufacturing better products and providing better services at a better price to the benefit of all of our citizens.

Corporations are in business to make money and we want them to be prosperous because we expect to share in that prosperity. The activities of the corporate raiders, however, are not at all conducive to those objectives. Rather, we view corporate takeovers as a method to make enormous profits for the already rich without creating anything new in the way of jobs, products or enhanced competitiveness. They are, in our opinion, "sterile" transactions.

The world economy has never been so competitive as it is today. We face an enormous and rising trade deficit which simply means that not only are we having difficulty competing abroad, but we're having trouble competing in our own backyard.

Corporate America has been castigated, and I think rightfully so, for paying too much attention to the short-term bottom line at the expense of long-term competitiveness and thus future job security. There must be

investment in quality, innovation and product development if corporate America and our high standard of living is to survive. As a Nation, we must make the necessary preparations to replace our aging equipment and facilities. We must invest in our future if we expect to have one.

Such a long-term outlook and philosophy, however, seems to be an invitation to the corporate raider who regards stock prices as the only proper measure of a company's success or failure and who sees a company with vision as an opportunity for a quick buck. The raider can step in, force a company to change its direction in response to a takeover threat and in the process reap millions of dollars through greenmail or through the systematic dismemberment of a company.

American corporations thus find themselves caught in a double-bind. If they put emphasis on short-term results and stock price at the expense of capital investment, research and development, they run the very real and probable risk of losing their ability to compete over the long term. If they pursue a long-term growth strategy, the short-term bottom line may be affected and lead to an undervaluation of the stock and a takeover threat. It can be a classic no-win situation.

That is precisely what happened to Goodyear as a result of Sir James Goldsmith's hostile takeover effort. We regard this as a misuse of wealth intended to benefit Goldsmith and his associates--no one else. I see no altruism in Goldsmith's actions, a statement I believe he would agree with. He is in this to make money, pure and simple, and he makes money through rising stock prices or by selling off assets. I find it hard to believe that there is any real concern for the employees or the communities involved. Nor do I believe he is overly concerned with any shareholder other than himself, despite protestations to the contrary.

To fend off the takeover attempt, Goodyear restructured itself. Goodyear's restructuring has thus far meant \$4 billion of debt, the sale of certain subsidiaries to finance that debt and a cost reduction program that has resulted in jobs being lost and plants being closed.

According to the Company, when the restructuring is complete, Goodyear will be 12 percent smaller. Goodyear has already announced the closing of three of its plants and has recently said it may close more as part of its strategy to recover from last year's takeover bid by Goldsmith.

The plant closures are tire plants in Cumberland, Maryland and Toronto, Ontario and a shoe products plant in Windsor, Vermont.

In Cumberland, over 1,000 Rubber Workers (Local 26) are losing their jobs along with more than 600 white-collar employees. Our members in that plant earn an average of \$11.72 per hour excluding fringe benefits. Some \$25 million of wages a year will be directly taken out of the Cumberland economy, a figure that will grow as the negative multiplier effect takes hold. Manufacturing wages generally multiply 6 or 7 times through the economy which means that the loss of the Cumberland jobs could cost the local economy \$175 million annually. This estimate considerably understates the impact, however, because it does not include the white-collar workers.

In Toronto, nearly 1,400 URW members (Local 232) and roughly 200 white-collars will lose their jobs in a couple of months. Our members make \$14.07 per hour there. When they leave Goodyear, \$40 million (Canadian) will initially be pulled from the local economy which will ripple into a loss of some \$280 million a year. Again, this estimate does not account for the impact of the salaried personnel who will lose their jobs.

In Windsor, Vermont, the 300 members of URW Local 289 earn an average wage of \$9.50 per hour. The closing of that plant will mean the loss of about \$6 million to the local economy. The multiplier effect will up the eventual cost to \$42 million annually, exclusive of white-collar layoffs.

In addition to the closing of these three plants, other consequences of last November's raid include the loss of 80 hourly jobs in Akron (URW Local 2) with the immediate potential for 40 more and the negotiation of

concessions at the Company's Gadsden, Alabama tire plant (URW Local 12) which are expected to provide some \$20 million relief per year with half that coming from wage cuts. The two together can be expected to take a total of \$72 million out of their local economies.

Local 2 also recently agreed to a collective bargaining agreement with Motor Wheel Corporation, the new company that bought the Goodyear rim plant in Akron. The sale of this plant was part of Goodyear's restructuring program. While the new contract maintains the previous wage level, it does not contain provisions for vacations, pensions or plant closure notification, items that were a part of the contract when Goodyear ran the facility. Employment at the plant is expected to decline from about 400 workers to 175 workers by the end of the year.

Even so, hourly workers in Akron have not been hit as hard as salaried workers. Some 600 Goodyear salaried positions in Akron have been eliminated. All told, about 1,800 salaried personnel have been cut throughout the Goodyear system since the restructuring began.

Goodyear's remaining employees' futures are far from secure, endangered by the decision to chop the research and development program by 7 percent and reduce its capital expenditures by \$275 million in order to provide cash to handle its new debt.

People are our bottom line. Where will these people and possibly many others find new jobs? The statistics indicate that getting a new job in this Country is often a lengthy process and that, in most cases, the new job offers less in wages and benefits than the old one. Consequently, the workers' standard of living is lowered. But the cycle doesn't stop there: other businesses in the affected community stand to lose as their customers now spend less; the tax base of the community and the public services it is able to offer are likely to be cut. This is all part of the negative or reverse multiplier effect that ripples throughout the economy and touches the lives of many not directly associated with a plant closure or massive layoff.

The human costs of plant closures and indeed, enforced unemployment for whatever reason, however, are even more alarming and represent an even more terrible waste: the waste of our nation's most valuable resource—its people.

A definite relationship between unemployment and physical and mental illness has been documented. According to the Institute for Social Research at the University of Michigan, plant closings are accompanied by increased incidence of arthritis, high blood pressure and ulcers among terminated workers. Psychologists and social workers have found noticeable increases in divorce, alcoholism, child beating, depression, drug abuse, suicide, criminal behavior and poor mental health among the unemployed. Dr. M. Harvey Brenner of Johns Hopkins University prepared a study in 1984 for the use of the Joint Economic Committee of the U. S. Congress titled "Estimating the Effects of Economic Change on National Health and Social Well-Being." Among the many statistics generated from Dr. Brenner's investigation is one which shows that among those who are forced into unemployment through the closing of a plant, the suicide rate is thirty times higher than that of the rest of the population.

In a takeover battle then, workers, customers and the community, factors generally recognized as of little concern to the takeover artist, are ultimately the losers. Workers who often finance the costs of a raid by job losses or pay cuts. Workers who may keep their jobs for now pay the price of job insecurity as they run the very real risk of losing those jobs later on as the Company finds itself becoming less competitive in the future.

Other companies in the rubber industry that have had experience with corporate raiders include BFGoodrich and Uniroyal. Goodrich paid greenmail to Carl Icahn. Uniroyal did the same, then entered into a leveraged buyout situation before selling its operating companies to pay off debt incurred in the LBO and then finally liquidated the Company. So far, our people still have their jobs, but they certainly didn't get rich as a by-product of the entire transaction. Icahn and those involved with the LBO made millions.

As this statement was being prepared, another major rubber company with its headquarters in the Akron area was hit with a hostile takeover attempt. On March 17th, GenCorp, known as General Tire & Rubber Company until 1984, found itself the target of a takeover attempt by a partnership affiliated with AFG Industries Inc. and Wagner & Brown. AFG Industries is an Irvine, California based glass maker while Wagner & Brown is a privately held oil and gas concern headquartered in Midland, Texas. The partnership has made clear its intent to sell GenCorp's aerospace and soft drink bottling businesses to repay debt incurred in the takeover. It is unrealistic to expect the rest of GenCorp's businesses to be unaffected.

Whether this attempt succeeds or not, GenCorp, like Goodyear, will be a different company in the near future. It will either be radically restructured or dismembered depending on which side wins the contest. Jobs will be lost, communities will be affected either way.

There is something inherently wrong with our system when it allows and even encourages this kind of corporate extortion. This kind of power must be curbed. A business should be able to operate to benefit its customers, its owners, its employees and its community—not the corporate raider who generally knows little or nothing about the company, he is raiding or the industry in which that company operates, who does not care what hardship his tactics may bring to the people who work for the target company and to the community at large and who is motivated by only one thing—money.

We are asking the Congress for help in "restructuring" our laws so they do not allow the dangerous speculative excesses that feed the takeover epidemic.

We see the following as steps that can afford protection to workers involved:

1. Greenmail should be prohibited.
2. Our securities laws should be examined with an eye toward stopping hostile takeovers.
3. Laws regulating banks and investment companies should prohibit involvement in a hostile corporate raid.
4. Mechanisms need to be developed to protect the interests of workers and communities affected by takeovers such as requiring anyone who gains control through stock manipulation to operate the corporation in its form at the time of its takeover for three years.

As I stated earlier, the activities of the corporate raider represent a serious threat to our Nation's future economic competitiveness. I cannot stress that strongly enough. I am very concerned that our ability to remain a major world economic power is being compromised and damaged beyond repair.

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United Rubber, Cork, Linoleum &
Plastic Workers of America, AFL-CIO, CLC
International Union

87 South High St.
Akron, Ohio 44308
216/376-6181



Milan O. Stone, President
Joseph H. Johnston, Vice President
Kenneth L. Coss, Secretary-Treasurer

April 29, 1987

Howard M. Metzenbaum, Chairman
Subcommittee on Antitrust,
Monopolies and Business Rights
Committee on the Judiciary
United States Senate
Washington, DC 20510-6275

Dear Senator Metzenbaum:

Enclosed is my response to the questions regarding corporate takeovers that were posed in your letter of April 3rd.

I want to thank you for the opportunity to appear before the Antitrust Subcommittee on this issue. It is my hope that the Congress will be able to fashion legislation that will effectively address the issue of hostile corporate takeovers and the economic and social hardships that seem to inevitably accompany them.

If we can be of any further assistance as this matter is pursued, please do not hesitate to contact me.

Sincerely,

Milan Stone
International President

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enclosure

cc: Vice President Johnston
Secretary-Treasurer Coss

1. What has been the impact of Goldsmith's attempted takeover of Goodyear on employees and on the citizens of Akron?

Speaking strictly to Akron, the impact thus far has meant 1) the loss of 80 hourly jobs with the short-term potential for 40 more, 2) a concessionary collective bargaining agreement for those hourly workers with Motor Wheel Corporation, the new company that bought the Goodyear rim plant in Akron, 3) the elimination of roughly 600 salaried positions at Goodyear headquarters, and 4) uncertainty for employees of Loral Corporation, the New York company that bought Goodyear Aerospace.

It is difficult to estimate the economic impact from the sketchy information available to us; however, the loss will surely be substantial. How much it affects the local economy is uncertain. The Akron area has gone through one major layoff after another and has survived, but each instance has taken its toll and I am concerned that this continued erosion of the area's industrial base is seriously undermining the stability of the local economy.

I have enclosed a copy of an article from the March 1, 1987 issue of the Akron Beacon Journal which addresses the emotional problems that have accompanied the changes at Goodyear.

The Company's decision to reduce its research and development program and its capital expenditures in order to help provide the cash needed to pay off its new debt, which not having an immediate impact, will likely be felt in the future.

Of course, the adverse consequences of the takeover attempt and its aftermath are not confined to Akron. Probably the community hurt the most by these recent events is Cumberland, Maryland, a small town in which Goodyear is a major employer. About 1100 Rubber Workers will lose their jobs.

Toronto, as a whole, will hardly notice the closing of the Goodyear plant in that city, but I can assure you that the 1600 people losing their jobs there will feel its full impact just as surely as they will in Cumberland.

2. What should Congress do to prevent the manipulation of pension funds in takeover battles?

Under current law, as I understand it, an overfunded pension plan can be terminated by the company and the excess funds will revert to the company as long as the funds' liabilities are satisfied and such action is not specifically prohibited by an agreement between the company and the employees.

This can lead to two types of abuses as regards corporate takeovers. In one instance, a company can tap its own pension fund and use the money to help finance the takeover of another company. In the

other, a raider may take over another company and then use that company's excess pension funds to help pay off the debt incurred in the takeover.

In either case, money that rightfully belongs to the employees is used to help finance a takeover instead of providing additional benefits to the worker or serving as a cushion in case pension fund investments do less well in the future. Such activity should, in our view, be prohibited.

3. You testified that you would like Congress not only to ban unfair takeover-related practices like greenmail, but to stop hostile takeovers themselves. Some hostile takeovers may be good for shareholders, management and even workers to the extent they improve long-term productivity. Though jobs lost in takeovers are a serious problem, aren't you concerned that a total ban on hostile takeovers may be going a little too far?

Perhaps a total ban on hostile takeovers is an extreme position although I am convinced that such takeovers as a rule benefit the raider above all others. They are, as I indicated in my testimony, sterile transactions that do not create anything new in the way of jobs or products. In most cases, they put so much pressure on the immediate bottom line that research and development and thus long-term competitiveness suffer as well.

Conceding that an outright ban is not a realistic solution in our economic system, I fully support the proposals that the AFL-CIO has made to regulate takeovers. I think these proposals—some of which I believe you have proposed as well—would, in the vast majority of cases, effectively make them more difficult to accomplish by providing for more notice, more accountability, more shareholder democracy and by removing some of the easy money incentives such as greenmail that often lure the raider.

4. What specific worker protection measures should Congress consider in connection with takeover reform legislation?
 1. Make existing union contracts binding on corporate successors or new owners.
 2. Prohibit corporate raiders from tapping a company's pension fund and siphoning off so-called "excess assets" in order to pay off debt incurred in the raid. Also prohibit a company from tapping its own pension fund "excess assets" and using the money to help finance the takeover of another company.
 3. Eliminate "golden parachutes" that protect corporate executives, but not the workers, against loss of income if jobs are eliminated after a takeover.

4. The raider should be required to disclose the principal economic assumptions underlying their asset valuations and projections, the sources of and conditions on the raider's financing, the business plans for the target and any plans with respect to the closing or sale of any facilities of the target. Closing a plant should be allowed only with sufficient notice, perhaps six months.

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A sense of security is shattered

Goodyear changes hard for many, counselors say

By Larry Passafiume
and Brendan Brett

Source: Akron's business writers

In October, when he launched a hostile takeover bid for Akron's largest company, financier Sir James M. Goldsmith said, "I am a potential bringer of change . . . and I'm sorry about that."

Now, four months after Goldsmith's statement shook Akron, that change has come in layoffs, early retirements, and anguish for those who saw Goodyear as a source of economic stability for the rest of their lives.

Friday was the deadline for hundreds of Akron Metal Products plant workers in Akron to do what they thought they would never do again — apply for jobs some of them have held for decades. They faced choices of applying for jobs with the new owners of the Motor Wheel division — a group headed by Motor Wheel executives in Lansing, Mich. — trying to bump into another job at Goodyear or being laid off.

Four hundred workers at the rim plant, a unit of Akron Metal Products, and 400 more on layoff were affected. Only about 12 percent were eligible to bump into Goodyear — a move that many consider most desirable.

Uncertainty also clouds employees of Goodyear Aerospace, Akron's second-largest employer, which in a few weeks will sever its 63-year tie with the parent company to become part of Loral Corp. of New York. About 6,000 salaried and hourly workers are affected.

And at Goodyear headquarters and tire division, hundreds of employees have left or are leaving either through accepting incentives for early retire-

ment or being laid off. Employees who accepted the early retirement had to depart by Saturday.

"It's like a living death for some people," said family counselor Dr. Art Stennett of Cuyahoga Falls, who has worked with people affiliated with the company.

"A part of Goodyear died," Stennett said. "Someone bought it. It's not the same. People are shocked. There's despair, sorrow and anger, guilt and depression. Apathy sets in. Then people begin to rally and pick up the pieces."

One Akron job placement firm helping people pick up the pieces has hired three additional staff members to handle inquiries from victims of the takeover attempt. Ed Rose of Sanford Rose Associates, said: "We never saw this kind of insecurity before. It's never been this bad."

Goodyear's own management has addressed the situation as well. Workers who received early retirement options met with personnel department officials to review their situations. A three-day outplacement program at the University of Akron was available for those laid off.

One Aerospace worker who asked not to be identified described Goodyear's decision to sell the subsidiary as traumatic for the employees.

"There is a deep-seated feeling of patriotism to Goodyear after you've been with a company for a number of years," the employee said. "I expected to retire from the Goodyear Tire & Rubber Co. I've got 30 years in, and I'm not going to retire from Goodyear."

I'm going to retire from a company I know nothing about."

At Aerospace, rumors abound that Loral's management believes Goodyear's operation was bloated by layers of surplus personnel. Even if Aerospace wins a contract to build a prototype Navy surveillance blimp, there are fears of layoffs and cutbacks.

Some employees who are near retirement age fear Loral may change the criteria for retirement and the benefits that accompany it.

Low morale is another problem, employees say. At Akron Metal Products, "It's rock bottom," said the wife of one employee. "They feel like they've been used up and tossed on the heap."

A drop in morale is "only natural," said Verlin Miller, a social worker at the Cuyahoga Valley Community Mental Health Center. Miller said workers may be suffering from insomnia, depression and anxiety and having digestive problems as well.

"It's probably not their lifestyle to seek counseling," Miller added, "but they ought to make sure a general practitioner is aware of their condition. Their physician can refer them for outpatient counseling."

Union leaders at Aerospace and the metal products plant say employee insurance programs would cover expenses for counseling for emotional distress. Goodyear's medical coverage of salaried workers also calls for expenses relating to psychiatric care.

There have been isolated reports of retirements being treated as more paler work without the usual friendly send-offs, parties and well-wishes. But company spokesman John Perduyn said he knew of a number of retirement celebrations at local restaurants and night spots.

Miller said that's a good sign. "Those ceremonies give a signal to employees, a sense of closure," he said. "They are anticipated and provide a sense of recognition."

Nevertheless, counselor Stennett said there are cases where the separation creates feelings that are too great to be assuaged by well-wishers at a party.

Stennett said the level of emotional involvement of some workers displaced by Goodyear is similar to the shock the nation suffered when President John F. Kennedy was assassinated.

"Kennedy was kept alive by people for a long time," Stennett said. "We relived his presidency with the family at the grave every year. People still get choked up about it."

"With Goodyear, we just had the open house (at the Goodyear blimp hangar in September). You have the blimp and all the rest of the company's tradition. The new company (Lorai) is just not a name that's alive. People haven't accepted it."

Both Stennett and Miller said it may take some people two years to become oriented to life without Goodyear. "You have to go through the first Thanksgiving, the first Christmas, and all the anniversaries without it," Stennett said.

"People have leaned on Goodyear as a support. They're asking, 'Who's going to take care of me now?' It fades away, but some people need help to let go."

URW president Bill Breslin acknowledged uncertainty about the future is a problem. "There's just



Stennett Journal photo / Don Benson

Family counselor Dr. Art Stennett at Falls office

been a lack of information," he said. "People think there must be something hidden. That leads to rumors. We're trying to answer all questions."

Company spokesman Perduyn said, "Rumors are always going to happen. It's not that information was withheld. It was just plain unavailable."

Some workers — both hourly and salaried — are faced with the decision of retiring now from Goodyear, or staying with scheduled retirement plans. That means retiring under new owners, and there have been fears — justified or not — about benefit

programs and pension rights being placed in jeopardy.

George Lenox of Altron recently retired from an upper management position as director of company advertising. Lenox said the timing of his retirement was coincidental with the takeover.

Having talked with former associates since he left the company, Lenox said, "They're all optimistic about the way the restructuring is being handled and the way it's going."

But one Aerspace employee said she felt let down by Goodyear. "I felt from the beginning year, 'I really sold us out,'" she said.

Senator METZENBAUM. Thank you very much.

Senator SIMON. Mr. Chairman?

Senator METZENBAUM. Senator Simon.

Senator SIMON. Yes. Unfortunately, this is one of those horrible days where I have all kinds of schedule problems. I do think this hearing is extremely important. I commend you.

I do think there are things that generally we could agree on. I think, for example, from my previous conversation with Boone Pickens that he would favor outlawing greenmailing. I think there are some things that can be done.

We ought to also be looking at how we can encourage corporations to do long-term thinking, and I would just like to read a couple of sentences and insert a full statement into the record.

From Business Week here it says, "With institutions dominating the market constantly churning their portfolios in search of gains, keeping shareholders happy is much harder," says George M. Keller, Chairman of Chevron Corporation. "The institutions," he grouses, "have all the principles of a dog in heat."

That is a fairly graphic description. I think we have a major problem. We are not going to solve the whole thing with legislation, but I think there are some limits that most responsible people can agree upon and I hope we move in that area.

I thank you, Mr. Chairman.

[The prepared statement follows:]

PREPARED STATEMENT OF SENATOR PAUL SIMON

Mr. Chairman, first, I want to commend you for holding a hearing on this complex and important issue. I look forward to working with you, Senator Proxmire, Senator Specter and other Senators who have introduced legislation aimed at solving some of the problems we will examine today.

Concern over the effects of hostile takeovers has been growing steadily since the first one was completed in 1974. According to W.T. Grimm & Co., there have been 274 hostile takeover attempts from 1974 through 1987. Of these, 128 were successful.

Admittedly, hostile takeovers represent only a small percentage of the total number of mergers and acquisitions that occurred during the same 12-year period. I think it is clear, however, that the effects of these deals ripple into every sector of the American economy in sometimes harmful ways.

Hostile takeovers—and fear of hostile takeovers—are the driving force behind what is probably the most massive redeployment of corporate assets in American history. This frenzied process has many facets.

To avoid unwanted tender offers, many major businesses are using spin-offs, divestitures and stock buybacks to increase their stock prices. According to Business Week magazine, in 1986, 4,000 of America's largest companies spent \$200 billion to transform themselves.

In the last decade, investment bankers have become a dominant force in the securities markets. Instead of serving merely as trusted advisors to corporate clients seeking acquisitions, they now search out likely takeover targets and often participate in the resulting deals themselves. One large investment bank now employs a "creative director" in its mergers and acquisitions department. This person's job is to come up with ideas for deals the firm can suggest to clients and new prospects.

The invention of so-called "junk bond" financing has made even the largest U.S. companies available as potential takeover targets of much small firms. Fear of a junk bond-financed takeover attempt has caused corporate management to adopt potentially harmful "poison pill" defenses without shareholder approval or to take a company private through buyouts collateralized by the corporation's assets.

We will receive written testimony today from Clarence "Red" Johnson, the President and Chief Executive Officer of a well-run, innovative Illinois company—Borg-Warner Corporation. Mr. Johnson's statement details the ways in which corporate raiders, arbitrageurs and investment bankers can use the mere threat of a hostile takeover to create market speculation in the stock of target companies. The object

of these tactics is to generate a quick profit from stock trades or to extract a green-mail payment.

Mr. Johnson was scheduled to be here today. He was unable to do so because he is the midst of responding to the second hostile takeover attempt on Borg-Warner since late last year.

Wall Street is now in the throes of the worst insider trading scandal in its history. Some of the accused were employees of old, respected firms and many of them worked on takeover deals.

Some economists and their disciples in the Reagan Administration say this vast "restructuring" of Corporate America is generally healthy. They see this trend as a long-overdue downsizing and rationalization of our businesses. They assert that corporate raiders and their support troops in the mergers and acquisitions industry are merely brokers in a process that will leave American industry better able to compete in the world economy.

Other economists, most corporate managers and significant portions of organized labor think it will have the opposite effect. While few favor a prohibition of hostile takeovers, they feel that the frenzied pace at which American companies are being razed and restructured is forcing management into short-term measures to keep stock prices up. Many of these tactics include huge increases in corporate debt.

Economist Pat Choate of TRW, Inc., thinks that "... American business is too busy fighting Wall Street to fight Japan. How can anyone concentrate on doing what is needed for long-term competitiveness—spending for plant and equipment, R & D and job training—when they're so busy fighting for survival."

I agree that to a certain extent mergers and acquisitions, whether voluntary or hostile, can be tools for promoting efficiency in a growing and fluid economy. In some cases, hostile takeovers have raised the stock prices of poorly-run, undervalued companies, and the threat of an unfriendly takeover sometimes acts to discipline entrenched or unresponsive managements.

But many hostile takeover attempts have become the tools of individuals who are more interested in turning a quick profit than in running the businesses they acquire in a responsible fashion. Moreover, attempted takeovers sometimes force even well-managed companies to abandon long-term plans for growth to defend themselves in lengthy battles for corporate control.

I have trouble believing that the billions of dollars spend in takeover defense and mergers will help American companies find new oil wells, develop the next generation of semiconductor chips or reduce our unprecedented trade deficit.

Instead of investing in the future, many of our best producers are thrown into trench warfare in which the goal is not to have the competitive edge, but sheer survival. This is a prescription for slippage, not for economic vitality and growth.

Indeed, if interest rates rise or the economy slows down, the players and pawns in high stakes hostile takeovers contests may find themselves taken out of the game altogether.

I have introduced a bill that begins to address some of these complex problems. It does not prevent hostile takeover attempts, but it does slow down the pace at which they can proceed. It gives shareholders, management and the securities market earlier notification of attempted takeovers and more time to evaluate them. The bill also limits the pernicious practice of greenmail.

Like similar legislation of your own, Mr. Chairman, my bill will also give the anti-trust agencies more time to review the possible anticompetitive aspects of all types of acquisitions and mergers, both friendly and unfriendly.

Finally, my bill also requires the filing of information statements on the possible effects on employees and their communities of major acquisitions. While I am flexible on what the content of such a statement should be, I do believe that both the federal government and the public need more information about these important transactions.

Congress has been looking at takeovers and mergers with great intensity for the last several years. While we should act with care, I think we *must* act in the 100th Congress to address the most damaging aspects of the hostile takeover game.

Senator METZENBAUM. Thank you, Senator Simon.

Our next witness—we do not have a description of him. We talked about Mr. Mercer as being Chairman and Chief Executive Officer of Goodyear and Mr. Stone as being President of the United Rubber Workers.

Boone, we had a little trouble with you. We did not know whether to call you author or raider or self-proclaimed guardian of the shareholders.

Mr. PICKENS. Drop that "raider."

Senator METZENBAUM. Drop that "raider," okay.

Mr. PICKENS. Yes. The others are fine.

Senator METZENBAUM. The other stuff is all right, okay. Please proceed. You know we have a 5-minute rule. Both of them have violated it. We will let you violate it a little bit, not much.

Mr. PICKENS. If you need a replacement for "raider," go with a large stockholder that sometimes becomes active.

Thank you for inviting me to testify today and I request that my written statement be submitted for the record and I will summarize that now.

Senator METZENBAUM. Without objection, so ordered.

Mr. PICKENS. I am glad you called this hearing, Senator Metz-enbaum, because the subject cries for public debate. I first had the privilege to testify on takeover issues 3 years ago before the Senate Judiciary Committee and I am pleased to be invited back.

I am a geologist by education and currently serve as general partner of Mesa Limited Partnership. I have been in the oil and gas business since 1951, 36 years. In 1956, I founded Mesa's predecessor company with \$2,500 in cash and a \$100,000 line of credit. So you can see that I am very familiar with leverage.

When we went public in 1964, our assets were valued at slightly less than \$2 million, and today they are in excess of \$2 billion. Mesa ranks as the largest independent oil and gas company in the country.

While building Mesa, I became a student of the free enterprise system. I have learned a lot about corporate America along the way. At times, the lessons I learned were contrary to popular theories and beliefs, but for the most part experience has proved those lessons to be correct.

In the wake of the recent insider trading scandal, the business establishment has raised a hue and cry that unsolicited corporate takeovers must be stopped. The Business Roundtable has seized the opportunity to trot out its tired anti-shareholder, pro-management agenda one more time and Congress has been inundated with pleas for reform.

Insider trading is illegal. It costs shareholders money and it should not be tolerated. I wholeheartedly support the SEC's request for an increased enforcement budget. Insider trading is a parasitic——

Senator METZENBAUM. We are having a little trouble hearing you. You are speaking very softly and I know that is not your style. [Laughter.]

Mr. PICKENS. I do speak kind of softly. Can you hear me better now?

Senator METZENBAUM. A little better.

Mr. PICKENS. Okay, good.

The SEC's request for an increased enforcement budget, I agree with. Insider trading is a parasitic crime and the way to stop it is to catch and punish the cheaters, not to shut down the legitimate business activities that are associated.

Eliminating takeovers, which in some cases may have created opportunities for illegal insider trading, is like shutting down the banks to stop Jesse James. Although I caution you not to confuse insider trading with legitimate takeover activity, that does not mean that I believe our takeover laws are perfect, and I will suggest some specific changes today.

Specifically, here is my list. I would outlaw greenmail, outlaw poison pills and other shark repellants, close the 10-day 13(d) window, require summaries of proxy statements, reform the proxy process so that shareholders can vote confidentially, require a one-share, one-vote standard for all securities exchanges, and encourage employee stock ownership plans and other incentives to employee ownership.

That is a summary of my opinion on the needed legislation. As you consider the variety of opinions on this subject, I urge you to question what is motivating those who are suggesting changes.

I am asked about my motives every day and in the eyes of my critics, my biggest flaw seems to be that I have made money in the takeover business, buying undervalued assets in a public marketplace.

The fact that I have been successful appears to distract some people from what I am saying about what has gone wrong with the system. When the good old boys of corporate America appear before you, look closely at where their interests really lie.

When they say they are long-termers, ask how much stock they own in the companies they manage. Ask how long they have been CEOs of those companies. Ask them what percentage of their total personal assets that ownership in the company represents. In other words, ask them if they have made a long-term commitment to their employees and stockholders.

Then take a look at their compensation. Is it tied to long-term or short-term results? They are compensated on an annual basis. Their annual salary and bonus structure makes them the shortest of short-termers.

Now, I would like to comment on a number of the most important issues which I mentioned earlier. My written statement discusses them in more detail.

Senator METZENBAUM. Boone, would you be good enough to summarize in about 2 minutes because we have a roll call and we have got about 6 minutes to get there?

Mr. PICKENS. Okay. I will have to read fast.

Senator METZENBAUM. Instead of reading, why do you not tell us what is on your mind?

Mr. PICKENS. All right. I am going to go down to—

Senator METZENBAUM. Would you rather that we recess and come back?

Mr. PICKENS. No. I have got it, I am okay. I will just go down to—the anti-greenmail legislation should be a one-liner: No management can make a premium to market offer to any shareholder unless it makes the same offer to all shareholders, regardless of how long they have owned it.

Ownership is ownership. This should not discriminate against shareholders based on the length of time they have owned their

stock. Poison pills and other so-called shark repellants should be prohibited.

I have got to tell you a quick story at this point. I got a call from a director of a corporation in this country about 4 months ago. He called me from a recess in a directors' meeting and he said how would you handle this one? He said we are in; we have got a big stockholder and he is causing us problems. He said would you consider greenmail to him?

I said let me tell you how I would handle it, and I said I know the guy well. I said I would tell him he can come on the board of directors and be a part of this organization and help us do well for everybody involved, both stockholders and employees of the company. If he does not want to do that, he can sell his stock on the open market just like he bought it, and I said it would be a short phone call.

The vote in that situation was eleven to two to give greenmail. He was one of the ones that voted against it.

In conclusion, I blame executives who have shirked their accountability for their companies' inability to compete. We know what happens when executives achieve job tenure. We are experiencing it today in the form of record trade deficits and plant closings and job losses. Managers should be held accountable for their performance, past and present, just as members of Congress are held accountable for their performance.

Every member of Congress would probably welcome a tenured position, but they must face their constituents before each election and convince them of the merit of their ideas. This accountability is the foundation of our system of democracy.

Similarly, corporate managers should not be tenured or be unaccountable to the constituents, the shareholders. An open market for corporate ensures accountability in corporate America just as elections ensure accountability in American government.

American workers are the best workers in the world. American managements are mediocre, at best. Instead of protecting those who are responsible for this country's lack of competitiveness, Congress should enhance market forces that promote accountability. Restore accountability and you will restore competitiveness, and it is that simple. Otherwise, America is going to continue to lose ground.

Thank you.

[The prepared statement follows:]

Statement of T. Boone Pickens, Jr.
General Partner, Mesa Limited Partnership
United States Senate
Before the Subcommittee on Antitrust, Monopolies
and Business Rights
Of the Committee on the Judiciary
April 2, 1987

Thank you for inviting me to testify today. I first had the privilege to testify on takeover issues three years ago before the Senate Judiciary Committee. Since then, your experience with these issues, as well as mine, has increased significantly.

I am a geologist by education and general partner of Mesa Limited Partnership. I have been in the oil and gas exploration and production business since 1951. In 1956, I started Mesa's predecessor company with \$2,500 in cash and a \$100,000 line of credit. When we went public in 1964, our assets were valued at slightly less than \$2 million. Today our assets are in excess of \$2 billion.

While building Mesa into the largest independent energy firm in America, I became a student of that system. I've learned a lot about corporate America. At times, the lessons I have learned have been contrary to popular theories and beliefs, but for the most part, experience has proved those lessons to be correct.

I would like to state to you briefly what my experience has taught me regarding some of the issues before your committee and the 100th Congress.

Greenmail

Greenmail should be prohibited. Anti-greenmail legislation should be one line long: No management can make a premium to market offer to any shareholder unless it makes the same offer to all shareholders prorata. I have never accepted greenmail, although I have been offered it by self-serving management in all but one of the transactions in which I have been involved as an unsolicited purchaser. In one deal, I was offered greenmail six times during the course of negotiations, three times in one day.

Certain anti-greenmail bills recently introduced in Congress

prohibit the payment of greenmail to shareholders who have owned their stock for less than a specified period of time, but allow management to pay greenmail to so-called long-term holders. Effectively, these proposals would prohibit payment of greenmail to short-term shareholders but still permit management to buy-off long-term shareholders who, perhaps after years of less than adequate performance by management, have decided to play a more active role in the management of their company in the hope of improving its performance. This is wrong. In no circumstance should Congress discriminate against shareholders based on the length of time they have owned their stock. Ownership is ownership. Whether a shareholder inherited his stock fifty years ago or bought it fifty minutes ago, that shareholder owns the stock. Shareholders should not have to prove themselves to management; it is management's job to prove itself to shareholders.

In the case of greenmail payments, the real culprits are weak managers who are willing to use shareholders' money to get rid of a perceived threat to their autonomy. I would much rather see managements propose to their shareholders that companies' charters be amended to prohibit greenmail than see Congress prohibit it. However, since companies have not adopted policies against greenmail, then I support legislation outlawing greenmail.

Poison Pills

Poison pills also should be prohibited. They unfairly discourage legitimate attempts to change corporate ownership. More than any other antitakeover device, they undermine the Williams Act's attempt to ensure a level playing field for management and bidders. Poison pills usurp shareholders' right to accept or oppose bids. I cannot think of any justifiable reason for allowing management to construct insurmountable barriers against uninvited purchasers. Allowing management to adopt poison pills is equivalent to establishing a policy that all uninvited offers are necessarily bad.

In addition to poison pills, other so-called "shark

repellents" should also be prohibited. The "lockout" preferred stock issued by Diamond Shamrock in connection with management's efforts is a good example of an anti-shareholder shark repellent. As part of their defensive tactics, Diamond Shamrock's managers in effect sold a veto power over the common shareholders' voting rights through the issuance of preferred stock. Under the plan, Diamond Shamrock's management sold \$300 million worth of preferred stock to a large insurance company. This preferred stock carried class voting rights on decisions normally left to the common shareholders. As a result, the holder of the preferred stock was sold a veto over any takeover bid for Diamond Shamrock, a company valued in excess of \$2 billion. Such brazen schemes to protect management's power should not be tolerated. As in the case of greenmail, I would prefer the prohibition against poison pills and other shark repellents to come from within the business community, but since it has not, I support legislation against poison pills.

High Yield Bonds

High yield bonds, commonly referred to as "junk bonds," have played a positive role in contests for corporate control. High yield bonds are not the primary method for financing tender offers and unsolicited acquisitions. A 1986 study by the Congressional Research Service made at the request of the House Subcommittee on Telecommunications, Consumer Protection, and Finance stated that "high yield bonds, by any measure, are still a small portion of total merger and acquisition financing." A study by the Investor Responsibility Research Center concluded that for the first nine months of 1986, high yield bonds provided only 7.6 percent of all tender offer financing. Bank debt and internally generated funds are the primary sources for such financing.

High yield bonds have been tainted, however, by the role they have played in the financing of acquisitions. High yield bonds have made it easier for challengers to enter the market for corporate control. Prior to the development of the high yield

bond market, size alone could prohibit economically advantageous acquisitions and protect entrenched management of large corporations. It is no wonder that executives of large corporations are actively seeking to restrict their use. Unocal, in an effort to resist Mesa's attempted takeover, first petitioned the Federal Reserve Board to apply its margin rules to severely restrict the use of high yield bonds in acquisitions. A recent Business Week editorial referred to certain bills introduced in the 99th Congress to restrict high yield bond financing in takeovers as the "CBS and Unocal Management Relief Acts of 1985."

It is important not to lose sight of the valuable role high yield bond financing has played and can continue to play in our economy. Very few companies today qualify for an investment grade rating. In fact, less than 675 of the over 23,000 companies with assets in excess of \$25 million would qualify today for an "investment grade" rating. Most non-investment grade companies have been rated below investment grade because of their relatively small size or lack of credit history, characteristics that are not necessarily valid indicators of future capability to service debt. Today the high yield bond market is dominated by emerging mid-sized companies such as MCI, Charter Medical, Ramada Inns, and Kinder-Care Learning Centers. Non-investment grade companies, not the Fortune 500 companies, are responsible for most new job creation in the United States in recent years. In fact, since 1981, the Fortune 500 companies have reduced their workforce by approximately 12 percent, eliminating over 2 million jobs, while the economy as a whole has seen an increase of 38 million jobs since 1978.

Although high yield bonds have a greater risk than investment grade securities, the premiums earned on these bonds historically have significantly outweighed any added risk. The market balances risk of default against the premium above so-called "risk-free" investments, such as U.S. Treasury securities. Institutional investors and professional money managers who buy high yield bonds carefully analyze this risk and the premiums that these bonds offer.

Community Impact Statements

The impact of corporate activities on local communities is not a simple issue. My experience has taught me that if managers act in the best interest of shareholders, they also serve the best interest of employees, communities, customers, and suppliers. Secure jobs come from vigorous competition, not from artificial protections. When Mesa has attempted to purchase control of another company, we have believed that the company could be better managed and be a more efficient and more profitable company. Some managers, however, have used local communities to protect their own interests. We have seen managers actually make a concerted effort to terrify a community about a proposed takeover as part of a calculated strategy to retain control.

Proposals that bidders be required to file community impact statements are really aimed at obstructing hostile takeovers and not at protecting communities. Such proposals reflect a general hypocrisy in the way many people approach hostile takeovers. Any statement of the impact of a takeover on a community would be highly speculative and subject to misinterpretation and misstatement. Companies are not required to make community impact statements when they close plants, move offices, or lay-off workers. No one demanded a community impact statement when Apache Oil moved its headquarters shotgun style from Minneapolis, or when General Motors recently closed eleven plants and terminated over 30,000 employees. No one demanded a community impact statement when Exxon laid off more than 80,000 employees, many of whom were in Texas, Louisiana, and Oklahoma, areas already suffering from a weakened oil industry. Even Goodyear was not required to file community impact statements when it closed or sold thirty-four of its plants since 1975. Economics cannot be legislated.

The possibility of a takeover forces management to compete. If a company is competitive, its stock price is high, its employees are challenged, and it contributes to the economic

security of the community. When a company fails to compete, the foundation begins to crumble and all of these constituencies are threatened.

Schedule 13D Filings

The SEC has called for a closing of the Williams Act "ten-day window" related to "13D" filings. I do not object to this change, which would not upset the neutrality of the Williams Act. I object, however, to any change, such as lowering the 5 percent threshold, that tilts the playing field in favor of target management.

Shareholder Review of Tender Offer and Proxy Materials

Shareholders are not demanding more time to evaluate tender offers. This proposal came from target managers. Extending the minimum period a tender offer must remain open would not assist shareholders in deciding whether to tender their shares to a bidder. The market evaluates available information and responds very quickly, usually within a day or two after an offer is made. There is no question that tender offer materials can be voluminous and burdensome to read. I support proposals that tender offer materials be required to include a summary of the material terms and conditions of the offer.

Shareholders most clearly need assistance in their review of proxy proposals. Shareholders do not need more time to review proxy materials; they need proxy materials that are easier to understand. Proxy materials have become so convoluted that they are not easily understood by even the most sophisticated investors, especially in recent years when companies have been putting into place complicated takeover defenses such as stock with unequal voting rights, staggered boards of directors, and super-majority votes and other procedural requirements. Shareholders must rely on information provided by the media or the recommendations of self-interested management. All proxy materials should be required to include a summary of the material terms of all matters being submitted for a shareholder vote and should be written in a way that is easily comprehensible. In addition, I

believe we should reform the corporate voting process so that shareholders, like voters in congressional elections, can exercise their suffrage rights confidentially without the fear of pressure from management. Also, one-share, one-vote should be the standard for all markets.

Two-tier and Partial Tender Offers

Partial and two-tier tender offers are not necessarily bad or coercive. There seems to be a popular myth that in two-tier offers some shareholders are allowed to sell their shares while others are left out. Two-tier tender offers, however, do not discriminate among shareholders. Prior to refinements to Williams Act regulations made by the SEC, two-tier and partial tender offers often had the effect of coercing shareholders to tender their shares earlier than they would in offers for any-or-all outstanding shares.

The SEC has eliminated the coercive effect of such tender offers by extending proration rights throughout the offering period, ensuring that shareholders have the full period to consider the merits of the tender offer. The SEC has also changed the rules to permit a shareholder to withdraw shares previously tendered at any time throughout the offering period.

A 1985 study by the SEC's Office of the Chief Economist found that fewer shareholders tendered into two-tier and partial offers than into offers for any-or-all outstanding shares and also that the blended premium for two-tier offers and the price premium for any-or-all offers were approximately the same. Thus, the empirical evidence does not indicate that shareholders would benefit from further restrictions on two-tier and partial tender offers.

Hart-Scott-Rodino Waiting Periods

Any changes in the Hart-Scott-Rodino Act, including extending the waiting period after filing, should be designed to deal with antitrust issues, not securities issues. Hart-Scott-Rodino waiting periods should parallel the waiting periods of the Williams Act and both statutory schemes should seek to avoid

tipping the balance of regulation either in favor of target management or a bidder.

The antitrust laws have protected consumers and competitors from anticompetitive conduct in the energy industry. Despite the restructuring in the industry since 1982, concentration remains low. The Hart-Scott-Rodino timetables for premerger review worked effectively in the multibillion dollar mergers that have occurred since 1982. The merger that I am most familiar with is Chevron's acquisition of Gulf, which was the biggest merger in the history of American industry. In that case, the FTC was able to review the proposed transaction, obtain needed additional information, identify any potential anticompetitive problems, and negotiate remedies to those problems, all within the Congressionally prescribed timetables of Hart-Scott-Rodino.

In short, I do not see any practical need to tamper with the Hart-Scott-Rodino timetables. I do not hear the FTC or the Justice Department demanding such changes. I am afraid that the current proposals are just one more of many "adjustments" being pushed by the tenured corporate establishment. Ultimately these changes threaten to eliminate the beneficial role played by mergers and acquisitions in restructuring corporate America. This restructuring is essential to our survival in the world economy. If antitrust enforcement is the problem, Congress should address it directly, rather than by tampering with the Hart-Scott-Rodino timetables.

I am aware of the Chairman's concern over the "partnership exception." I do not oppose efforts by the FTC to deal with this issue. In particular, I urge the committee to recognize that Hart-Scott-Rodino filings act as de facto securities notifications to target companies. Congress should encourage the preservation of parity between the key securities statute, the Williams Act, and Hart-Scott-Rodino to avoid unintended conflicts.

Policing Insider Trading

In the wake of the recent insider trading scandal, the business establishment has raised a hue and cry that corporate take-

overs must be stopped. The Business Roundtable has seized the opportunity to trot out its tired anti-shareholder, pro-management agenda one more time, and Congress has been inundated with pleas for reform.

Insider trading is illegal. It costs shareholders money, and it should not be tolerated. I wholeheartedly support the SEC's request for an increased enforcement budget. Insider trading is a parasitic crime. The way to stop it is to catch and punish cheaters, not to shut down the legitimate business activities on which they prey. Eliminating takeovers which may create opportunities for illegal insider trading is like shutting down all the banks to stop Jesse James. The SEC needs more people to enforce its regulations. Vigorous enforcement of current laws will deter would-be cheaters and ensure that those who do cheat are promptly caught and punished.

The "Hostile" Distinction

Top on the Business Roundtable's agenda is stopping so-called hostile takeovers. The Business Roundtable says that besides breeding insider trading, hostile takeovers force managers to focus on short-term results, burden companies with excessive debt, and threaten communities.

The Business Roundtable was formally organized in 1974 to formulate and present a consolidated response to the rising level of government intervention in business. The Business Roundtable consists of the chief executive officers of the largest Fortune 500 companies. In the mid-to-late 1970's and early 1980's, the CEOs of the Business Roundtable and their lobbyists swarmed Capitol Hill telling of the wonders of conglomeration. They argued for relaxed antitrust policy and said mergers and acquisitions were natural products of free enterprise. The big ones were swallowing the little ones, and vast corporate empires were being assembled. That was free enterprise. Then one day someone figured out how a little one could swallow a big one. The business establishment ran back to Capitol Hill and said, "we've got to stop this -- they're tearing down America."

It is ironic that the same business community that pursued

deregulation as the savior of free markets so quickly, and apparently without embarrassment, became the champion of such an intrusive scheme to regulate legitimate business activities. There is little question as to why this is so. Simply, it is because regulation, or protection from the market, is in management's best interests. It is no surprise that the vast bulk of the recent growth in the job market has been created by companies other than those represented by the Business Roundtable.

The Business Roundtable wants hostile takeovers stopped, but would allow "friendly" mergers to continue regardless of how much debt is created or how many jobs are lost. It wants community impact statements for hostile takeovers, but not for friendly mergers or corporate restructuring, regardless of how much dislocation they produce. Proposed distinctions between "hostile" and "friendly" takeovers in the context of government regulation are not appropriate. Takeovers should not be treated differently under the law based upon how they are viewed by management.

The Business Roundtable's position reflects a clear conflict of interest. The hypocrisy that pervades the debate over mergers and acquisitions shows that the real concern is not debt levels or long-term growth of companies; rather, the concern is with preserving the corporate establishment. Newsweek exposed the hypocrisy of incumbent management's position when it chose as its "best quote" of 1986 a statement by Roger Smith, chairman of General Motors. According to Mr. Smith, corporate "raiders," to use his term, "destroy [shareholder] equity. They destroy jobs. They destroy communities. All for their own gain. That's not right . . ." Newsweek pointed out that Smith made that statement shortly after GM closed eleven plants and terminated over 30,000 employees, just before paying H. Ross Perot \$743 million for his equity in GM. The most revealing aspect of the Perot buy-back is that Perot would be liable for up to \$7 million in damages if he later publicly criticized the management of GM in any way.

Separation of Ownership and Control

For at least three decades after World War II, American business enjoyed an expanding domestic economy and a dominant role in international trade. Our markets were not seriously challenged by foreign competition, and we maintained the financial clout to cover up even our worst business errors.

The post-war years also witnessed the advent of the professional manager who, it was theorized, could be trained to "manage" any large organization. Professional managers soon replaced entrepreneurs at the top of our largest corporations.

Along with the professional manager came a steady separation of ownership and control. That separation is important to what ails corporate America today. Professional managers have no significant ownership interest in the companies they manage. Managers with no personal stake have interests different from those of owners. Many of these managers are more interested in enhancing their own careers, maintaining their autonomy, and perpetuating their pay and perks than in maximizing results for the owners.

Top executives should have at least 75 percent of their net worth in the companies they manage; they should be willing to bet their personal fortunes on their own performances. Ninety percent of my net worth is invested in Mesa. Nine percent of the chief executive officers of the Fortune 500 companies do not own one share of stock in the companies they manage--not a single share--but their annual salaries and bonuses often equal well over one million dollars. Productivity and profitability of our companies could be enhanced if all employees owned stock in the companies for which they work. Congress should continue to encourage employee stock ownership plans and other incentives for employee ownership.

Failed Diversifications

The growing gap between ownership and control has distorted the traditional economic incentives that drive our free enterprise system, and many of our largest businesses have languished as a result. As our largest corporations matured,

managers experienced more and more difficulty finding sound investment opportunities within their core businesses. But, rather than distributing returns to the shareholders who had put their money at risk, they frantically diversified into unfamiliar businesses. Slow growth combined with strong cash flows tempted managers to use discretionary income to buy whatever was for sale. The urge to conglomerate overwhelmed any inclination to return cash to owners because managers' career and financial futures depended more on size than results. Mediocre results pacified shareholders, while an ever-increasing empire justified higher salaries, more perks, and bigger bonuses. Consequently, performance took a backseat to size.

Diversification created even larger and denser bureaucracies. As our bureaucracies grew, the American workplace became less and less stimulating, and creativity became more and more suppressed. Meanwhile, foreign competitors exerted immense pressure on our markets. While General Motors was assembling a fourteen layer tangle of managerial hierarchy, the Japanese automakers, with only five layers, rapidly ate away market share. Today we hear stories of giant insensitive bureaucracies that stifle individual initiative and avoid risk, and we see our market shares lost to creative and aggressive foreign companies. Big business' response? Run to Washington -- get protected.

In the 1980's, we have witnessed the failure of countless diversifications which were made in the 1970's. In my industry alone, Exxon bought Reliance Electric; Mobil bought Marcor, and Arco and Sohio bought into the mining business at the top of the cycle. Largely as a result of unwise diversification efforts such as these, the oil industry has written off in recent years over \$16 billion worth of failed investments. That figure does not take into account recent writedowns that were triggered by declining oil prices. I wonder how many jobs were lost and how much community dislocation was caused by these "friendly" transactions.

Undervalued Assets

As our largest companies floundered, opportunities were

revealed--opportunities to upgrade management and make more productive and efficient use of corporate assets. These opportunities were manifested in the form of undervalued assets which were available in a public marketplace. Entrepreneurial investors and disgruntled shareholders sought to take advantage of these opportunities with plans for restructuring bureaucratic behemoths into more efficient organizations. Other entrepreneurs were happy to make so-called short-term profits and to go away when weak managers elected to pay them off rather than heed warnings of corporate waste and inefficiency.

Opportunities for hostile takeovers were created by risk averse, unresponsive managers who had very little financial stake, besides their jobs, in the companies they managed. It is unfortunate that some big business' response to takeovers was not to become more competitive. Instead, big business often ran to Washington for protection.

Restructuring to Compete

Despite the pleas from managers whose jobs are threatened, the overwhelming evidence shows that corporate restructuring has been a powerful force for restoring America's competitive edge. For example, John P. Paulus, chief economist for Morgan Stanley, found that those industries and services which have had the highest proportion of mergers and acquisitions have recognized a commensurate increase in productivity.

A good example of that phenomenon comes from the manufacturing and mining sector. While it represents 25 percent of America's industrial output, 50 to 65 percent of all merger and acquisition activity since 1980 has occurred in this sector. During the same period, the manufacturing and mining sector reported annual productivity gains three times that of the nonfarm sector as a whole. Evidence from individual industries that have experienced heavy restructuring bears the same results. For example, a January 9, 1987, article in Investor's Daily documents dramatically increased efficiency and competitiveness in the paper industry attributable to re-

structuring. An analysis of several restructured companies appeared in the March 2, 1987, edition of Fortune magazine. The overwhelming conclusion reached by the analysis was that, although it may be disruptive and at times painful, continued restructuring is in the best interest of this country because it is making us more efficient and more competitive.

If there had been less protection, restructuring would have occurred earlier, and America would have remained competitive in some industries where we are now not even a factor. We also would have avoided some of the disruptions that have characterized restructuring.

Unfortunately, restructuring has not been initiated voluntarily. Though many CEOs have now jumped on the bandwagon, the fear of a forced reorganization or hostile takeover has been the driving force behind the changes. If we are going to prepare for the intense international competition of the 1990's and beyond, we must allow the current wave of restructuring to run its course. It is mandatory for survival.

Long-Term, Short-Term

The Business Roundtable argues that the threat of hostile takeovers distracts managers and causes them to focus on short-term rather than long-term results. This is a variation of what I identify as the long-term, short-term theory. According to this theory, the stock market in general, and activist shareholders and institutional investors in particular, force corporate executives to focus on short-term corporate performance at the expense of long-term corporate growth and development. According to proponents of this theory, shareholders who demand increased management performance are short-termers who should be ignored and whose ownership should be discouraged.

It is ironic that the Business Roundtable uses this theory to defend itself from challenges by shareholders, given that the compensation of these business executives is often based almost entirely on short-term, rather than long-term, performance. Managers should be compensated principally by means that bring their interests more in harmony with the interests of

shareholders, such as through stock ownership or stock options. As I said before, ninety percent of my net worth is invested in Mesa, and I believe the net worth of the CEOs of all our companies should rise or fall with the performance of the companies that they manage.

At first glance, the long-term, short-term argument appears to embody basic American values such as patience and perseverance. The theory is contradicted, however, by logic and readily available empirical data.

For example, if the theory were sound, it could be expected that increased stock ownership by performance-oriented institutional investors would cause management to forego expenditures on research and development. In 1985, the Chief Economist's Office of the SEC conducted a study looking for evidence to support this proposition. It did not find it. Instead, it discovered that as a company's average institutional ownership increased, its average ratio of research and development expenditures to corporate revenues actually rose. The study summed up its findings by stating:

The evidence strongly refutes the proposition that the stock market values only short-term earnings, and not expected future earnings. A logical inference to be drawn from this evidence is that it is futile for corporate managements to try to forestall a hostile takeover by pumping up short-term earnings at the expense of investing in long-term projects with positive net present values.

The long-term, short-term theory ignores that the stock market evaluates expectations of tomorrow's profits today. That is why when a pharmaceutical company like Upjohn announces a new drug, the company's stock price shoots up. The stock price goes up today not because investors expect sensational results for the next quarter, but because they recognize the potential for long-term profitability.

The same is true in manufacturing. When a company announces a promising new product or process, its stock price goes up immediately. The rise in stock price occurs even if the returns are not expected for several years. That shareholders invest based on long-term expectations of profit explains why companies that

invest heavily in research and development with promise for future returns, like Genentech, have high stock prices even though they may have relatively little or no current earnings. Indeed, the fact that companies trade at different price/earnings ratios suggests that the market is carefully judging managements' long-term plans and the probability of success of such plans.

People buy stock to make money, and shareholders are interested in making it sooner rather than later. People hold on to stock long-term not because they are long-termers, but because they believe they will make more money in the long run by holding on to it than they will in the short run by selling it. Shareholders base buy-sell decisions on their perceptions of the company's potential, not on whether they are short-termers or long-termers.

It is not enough just to have a long-term plan. Managers must have a promising long-term plan, and they must communicate their plan to the investing public. Managers with credible long-term plans do not have to worry about a takeover because their company's stock sells at a premium to the value of the company's underlying assets.

The greatest fallacy of the long-term, short-term theory is that it is most often offered as an excuse for the mistakes of the past. Careful, well-conceived long-range plans of yesterday should begin to pay off today, just as well-reasoned long-range plans of today will begin to pay off tomorrow. In other words, today's quarterly earnings should reflect the success of yesterday's long-term plans. Instead, some managers urge shareholder patience and forbearance in the face of less-than-adequate performance today by promising better times tomorrow. These managers in most cases are really asking for more time to repeat the very same mistakes that they made in the past. We cannot allow this cycle to continue.

Corporate Debt

As with the long-term, short-term theory, there appears to be something very American about the argument against corporate debt. Personally, I would rest more easily if I owed less, but I

would also be a less productive participant in our economic system.

Debt financing is one of the most powerful engines driving our economy. My experience over the last thirty-six years has taught me that debt is an excellent way to finance corporate growth, return values to shareholders, and to discipline wasteful managers.

Fears of excessive corporate debt are unfounded. Our free markets have proven themselves over and over to be efficient and successful evaluators of risk. Each time a commercial loan is made or a corporate bond is sold, an indepth analysis of the prospective risk is performed. In the case of mergers and acquisitions, this analysis is often made by the best financial minds in the world. It would be misguided for Congress to impose arbitrary limitations on debt levels or methods of debt financing, and it would very likely be disastrous for our economy.

If Congress is genuinely worried about corporate debt, why do we perpetuate a system of corporate taxation that favors debt over equity financing? As long as there is a strong tax incentive to chose debt over equity, the current corporate debt levels will remain. The most effective way for Congress to lower corporate debt levels would be to make dividends deductible at the corporate level. If corporations could deduct dividend payments as they can interest payments, the bias against equity as opposed to debt financing would be eliminated. Under that balanced system, the after-tax cost of raising capital would not depend on whether debt or equity were used. A corporation's choice between using debt or equity for financing would depend purely on an evaluation of preferences of the capital markets.

Deductibility of dividends would have the added advantage of giving management a tax efficient way of distributing cash to shareholders when reinvestment was not attractive. Our free market would be much more efficient if managers' decisions of whether to use corporate income to reinvest, diversify, or reward shareholders were tax neutral. Once distributed, shareholders rather than managers could reallocate the capital within the

economy. Shareholders, rather than a narrow undisciplined group of managers with no financial risk, would decide which were the best investment opportunities.

Restore Accountability

Executives who are not accountable to owners have decreased our competitiveness in international markets. We know what results from tenuring executives; we are experiencing it today in record trade deficits, plant closings and elimination of jobs. Management should be held accountable for their performance, past and present, just as Members of Congress are held accountable for their performance. Every Member of Congress would probably welcome a tenured position, but they must face the voters and persuade them of the merit of their ideas as election day arrives. This accountability is the foundation of our system of democracy. Similarly, corporate managers should not be tenured or be unaccountable to their constituents--shareholders. An open market for corporate control ensures accountability in corporate America, just as elections ensure accountability in American public life.

Instead of protecting those who are responsible for this country's lack of competitiveness by restricting free market forces that exact accountability, Congress should enhance these forces. Restore accountability and you will restore competitiveness. It is that simple. Otherwise, we will continue to lose ground.

Senator METZENBAUM. This subcommittee stands in recess for the time that is necessary in order to do what has to be done on the floor of the Senate. We will be back in session.

Mr. PICKENS. Can you give us some estimate, 5, 10, 15 minutes, or what?

Senator METZENBAUM. I would guess—well, if we are going right into the vote on the highway bill, then we will remain. But if there is going to be debate, then we will come right back, and I would guess 10 or 15 minutes.

Mr. PICKENS. Thank you.

Senator THURMOND. Gentlemen, I want to welcome you all here. I have got another engagement after this vote is taken and I may not get back. I have three questions I will submit for the record, if you would not mind answering them.¹ We are very pleased to have you with us.

[Recess.]

Senator METZENBAUM. The subcommittee will come to order, please.

I want to make the observation that you win and you lose some. You have got me here and the Republicans in the Senate have the President over visiting with them at this particular moment, but I will not try to prevail upon you with respect to the highway bill, although I know your position, Mr. Mercer and Mr. Stone.

Mr. PICKENS. Can I make one concluding remark?

Senator METZENBAUM. Sure.

Mr. PICKENS. Okay. This will be very brief. Let me just say that I can remember very well in the 1970s that the large companies in this country spent a lot of time here in Washington trying to convince somebody that acquisitions were good.

The Business Roundtable spent a lot of money lobbying for that, and after 1980, well, it seemed like everything got pretty relaxed as far as acquisitions were concerned. I think the large companies in America were tickled to death with what they were able to work with.

But this was in a period where the big pitch—and I know you know it better than I do, Senator, but the pitch, as I recall, was that when a big company gets a little company, that is free enterprise and that should be allowed to go on. That is free market, free enterprise, and should not be stopped.

Do you remember the roll-up of the conglomerates and everything else? I can remember that argument. But then one day, and it was in 1984, somebody figured out how a little one could get a big one and the whole thing changed.

The Business Roundtable was back up here on the Hill and their lobby then was saying big one getting little one is free enterprise; little one getting big one is un-American.

Senator METZENBAUM. Well, let me ask you this question. I was going to ask Mr. Mercer a question first, but I will ask you. I understand what you are saying about big ones and little ones.

You have indicated your opposition to greenmail, but is it not fair to say that in one instance you did recent greenmail, and is it

¹ Not available at press time.

not fair to say that in another instance, or is my recollection wrong, the company worked out a procedure to pay everybody a higher price than you, but refused to pay you the premium they were paying everyone else? Am I not correct about that?

Mr. PICKENS. Did you say I had received greenmail?

Senator METZENBAUM. I said I thought in one instance you did.

Mr. PICKENS. No, we have never taken greenmail.

Senator METZENBAUM. You have never taken greenmail?

Mr. PICKENS. No, sir. We have been offered greenmail in every situation except the one you just mentioned, which was Unocal—we won in the chancery court in Delaware. It was appealed to the supreme court in Delaware and we lost. That was the first time that the Delaware Supreme Court had ever discriminated against a stockholder.

We were discriminated against; we were left out of the offer. A year later, the SEC reversed that under the Williams Act and all stockholders would have to be treated equal today. We were just a year too late was our problem.

Senator METZENBAUM. In the Unocal case, the company provided, that everybody would be offered "x" dollars except you?

Mr. PICKENS. Yes. That was the offer. The board of directors approved that offer and that was the way it was offered. They all got the offer but us. They identified it as reverse greenmail; that they greenmailed all the other stockholders and we were left out.

Senator METZENBAUM. What happened in the Phillips case?

Mr. PICKENS. The Phillips case was the one that—Phillips offered us greenmail, I believe, either five or six times. We turned it down. The final deal that was made—that was the one where we had an opportunity to put our stock to them, I believe, at \$53.

In the press release that we worked on with Phillips, they would give a package of securities that would equal \$53 to the other stockholders, and their two investment bankers, Morgan Stanley and First Boston, were in that press release and agreed to it.

What eventually happened—I think the reason why you think it was greenmail is because the market perceived that the value of Phillips—we had offered \$60, and so when all stockholders were treated the same with 53, we then—the next day, the price of stock went from like 54 down to 46.

That is where, you know, people said, hey, I had to take 46 and Pickens got 53. We did not get 53 until after the vote by the stockholders, and what happened then—it got clouded, but at the time that the vote was concluded, the deal was made and you actually could get more than 53 if you were a Phillips stockholder.

Senator METZENBAUM. But is it not the fact that the Phillips stockholders did not get 53 and you did?

Mr. PICKENS. No. I am saying if they stayed to the point that we stayed, they got more than 53.

Senator METZENBAUM. If they stayed what?

Mr. PICKENS. When we got paid, if they were still in, they got more than 53.

Senator METZENBAUM. But were they not getting 53 in securities and you were getting cash?

Mr. PICKENS. Senator, part was cash, yes, that is correct, and some was securities, but \$53 was the market value. All they had to

do was just sell the securities, but that is what I am saying. They got 53 in value, but at the time that we received 53, the value was above 53. So they could have liquidated for the cash just exactly like we did.

Senator METZENBAUM. But as soon as your deal was announced, the stock went down to 46?

Mr. PICKENS. Just as soon as it was, that is right, but we were not paid because the market perception was that the price was going to be substantially above that and closer to \$60.

Senator METZENBAUM. Let me get this straight. When you got your 53, at that very moment they could not get 53?

Mr. PICKENS. Yes, they could. That is what I am telling you. They had a basket of securities that had a 53-plus value to it at that time. Sure, they could sell out the same way.

Senator METZENBAUM. Why is there a public perception, or why has it always been reported that you got greenmail and the rest of the shareholders did not? Will you explain that to me?

Mr. PICKENS. Well, I think that is because the price of the stock—again, the perception in the marketplace—and this is one where Ivan Boesky took a tremendous loss. He was a Phillips stockholder and he believed in his analysis that the price of stock would be above the level where it was.

We made a deal with Phillips and included all the stockholders in the deal. There is testimony over at the SEC on this very question, and Joe Flom, who was lawyer for Phillips and lawyer for Mesa, so he was disqualified for either side, but became the intermediary and sat in on all the negotiations—Joe Flom's testimony at the SEC is that the bummiest rap Boone Pickens ever got was to be called a greenmailer in the Phillips deal because Joe sat right there and saw the whole transaction take place, and we did not take greenmail.

Had we wanted, Senator, to take greenmail, we could have taken \$300 million profit out and left the stockholders out on the limb if we had wanted to. I mean, that was there for us and we turned it down.

Senator METZENBAUM. Mr. Mercer, you recommend closing the 10-day window. My bill closes the window to one day and lowers the reporting threshold to 3 percent. Would you consider that a satisfactory approach?

Mr. MERCER. I think it is a vast improvement, Senator, over what we have now. We have, of course, gone to one day and we have said a threshold of 2 percent. I heard Mr. Cox suggest that that might increase the amount of paperwork, but 2 percent of a major corporation is still a lot of shares. In our case, it used to be over 2 million.

Senator METZENBAUM. Let me ask you a specific question. You know pretty much what my bill provides. In what points do you have disagreements with it? Do you have any problem about some prohibition with respect to poison pills?

Mr. MERCER. Only to this extent: We talk in terms of poison pills and, actually, we think in terms of shareholders' rights, and we put that in like it was a fire extinguisher on the wall, if you will, to be used only if necessary to delay the process so that the shareholders will have time to make an informed judgment on what is going on.

Currently, Senator, as you know, these things happen so fast that the shareholder, the average shareholder and the little guy never gets an opportunity to understand the magnitude of the operation and how it affects him directly.

Senator METZENBAUM. What could Goodyear have done differently to respond to the Goldsmith attack if the 10-day window had been closed at that time?

Mr. MERCER. We would have known about him a lot sooner. We would have known about the warehousing that takes place. I think that we would have an opportunity to maybe invoke the shareholders' rights plan, an opportunity to get word out to our shareholders.

Certainly, he would not have had 12.5 million shares in his pocket by the time he jumped out of the closet.

Senator METZENBAUM. Raiders say they like to target poorly managed companies and that their attacks discipline management. Can you give me some idea of what was the earnings record of Goodyear prior to Mr. Goldsmith's actions?

Mr. MERCER. We just had two back-to-back years of record earnings. As you know, we are the number one tire company in the world, with ever-increasing market share, with product innovations such as our Vector tire, which is the third generation of the all-season tire that we introduced into the marketplace. Our Eagle line of tires is unparalleled by anyone in any part of the world for sportscars and for the racing circuit.

So I would say that our company has been very successful, and I say that with a great deal of humility because I did not do it personally. We have had a legacy of very aggressive and competent CEOs, backed up by a team of competent managers.

You talk about the investment we have made in the company as individuals. I have invested 40 years in the Goodyear Tire & Rubber Company, and worked every day of it. The only digression I have had from the purpose of the corporation and my job has been what we are doing today and what started last November when I found myself having to prevent this unwarranted attack.

Senator METZENBAUM. You indicated, I think, in your testimony that Goldsmith went away with—I think he took about \$129 million.

Mr. MERCER. He had 94 in his back pocket and he left 72 on the table is the way my math comes out.

Senator METZENBAUM. Did he not also get about 30 million for legal fees?

Mr. MERCER. We paid his expenses of 37 million, as opposed to letting him go through with the program where the expenses would go as high as 150 million.

Senator METZENBAUM. Somebody told me that just his personal expenses in that settlement were \$75,000 a day. Is that misinformation?

Mr. MERCER. Oh, they were tremendous. He had his band of lawyers and a public relations firm, and whatever else is involved in it. He had Merrill Lynch, also, and I think they were in there for well over 20 million.

The expenses on these things, Senator, are just absolutely unbelievable. What we had to pay our investment bankers and the law-

yers—and I admire Mr. Pickens because he does not use investment bankers, but then if you are not going to get married, I guess you do not have to buy a preacher. [Laughter.]

But, you know, we have investment bankers in order to protect not only our directors, but our shareholders to make sure we are doing the right thing.

Senator METZENBAUM. How much did you pay your investment bankers for their advice in connection with this?

Mr. MERCER. We have not finished paying them yet. We want to make sure that we have a letter that says that there is no insider trading involved in our program, and we do not have that letter from them yet.

Senator METZENBAUM. And how much do you expect? What have you reserved and paid out?

Mr. MERCER. Well, it will be at least 5 million for the investment bankers to date. Now, how far that goes, we do not know yet because they are involved in the sale of assets and they get a pretty good fee for that.

All of these are negotiable because the figure was much higher than that before our fellows went to work on it.

Senator METZENBAUM. The 70 million you say that Goldsmith left on the table comes about by reason of the fact that the stock has gone up beyond the price you paid him?

Mr. MERCER. And the fact that we tendered at a higher price than what we paid him; those two conditions.

Senator METZENBAUM. Well, actually you tendered at—

Mr. MERCER. Fifty dollars, versus the \$49.50 he was paid for his shares.

Senator METZENBAUM. There is only 50 cents' difference in what you tendered, so how do you figure 72 million? He did not have 140 million shares of stock.

Mr. MERCER. But then the stock went up to 56¼.

Senator METZENBAUM. And now where is it?

Mr. MERCER. It is about—let us see; I looked last night. It is either 54⅞ or 55; it is in that range. It has not often been below 50 since we closed the deal with him.

Senator METZENBAUM. Could you argue that procedures that he was urging the company to take, some of which you did take when you divested yourself of some of the assets, were in the best interests of the shareholders even though they might not have been in the best interests of the community or the workers? Could he make that argument?

Mr. MERCER. Well, he would say that our divesting of ourselves of anything but the tire business would be in the best interests of the shareholders because that was the party line he used when he went into the raid.

Senator METZENBAUM. Mr. Pickens, your prepared statement says you support legislation outlawing greenmail of long-term as well as short-term shareholders. Would not a ban aimed at shareholders who have held stock less than 2 years such as the one I proposed accomplish the basic objective you support?

Mr. PICKENS. Well, Senator, I do not understand how you can pick 2 years or 6 months, or whatever. I see ownership as ownership. It would be like me selling you a car and telling you you can

pick it up in 6 months if it looks like you qualify as a good driver. It just does not make sense to me.

I mean, whether you bought something yesterday or whether you inherited it 50 years ago, it is yours.

Senator METZENBAUM. So your position is that all shareholders ought to be treated equally?

Mr. PICKENS. Absolutely. I do not see any way you can differentiate between shareholders. You know, if I might go back to 1984 where you and I worked on the merger moratorium situation and look at the three big deals of 1984, which would have been Chevron/Gulf, the biggest of all time, \$13 billion; the Texaco/Getty deal—and I will not get into whether they acquired them or not; that is another question, but that was a \$10 billion deal. And we had Mobil acquiring Superior for \$5.5 billion.

In all of those cases, if you recall, I was identified as a raider and a greenmailer and all kinds of things. My dad, who is 88 years old, said they called me everything but a chipmunk, and that was about right.

But you look at the other two companies, Texaco/Getty and Mobil/Superior, and you saw a large stockholder in each case who had inherited their stock, Gordon Getty at Getty and Howard Keck at Superior, and they were never called a raider; they were never called a greenmailer.

They took their companies out and put them on the block and sold them is what they did. We did not want Gulf to sell out; that was not even what our plan was. But we got all the attention. Gordon sold Getty out; Howard sold out Superior. There was no question about that. Everything went fine.

Howard got his money 6 months ahead of everybody else, and the shareholders got securities and he got all cash and nobody called him a greenmailer. It was interesting, and there was only one difference between the three situations—Gulf, Getty, and Superior—how long had you owned the stock.

We had owned the stock at Gulf 6 months and the others had inherited it 30, 40 years ago.

Senator METZENBAUM. Mr. Mercer, do you have any thoughts as to whether greenmail is appropriate if the stock is held longer? I mean, in all fairness, I think there is some merit in what he is saying. Why should any one stockholder get more than the others? I would like to get your reaction.

Mr. MERCER. Well, you know, we are opposed to greenmail and we did not pay greenmail, and I am interested to hear that we wound up with the same lawyer, who gave us the same kind of advice that you got to make sure that we did not pay greenmail.

Mr. PICKENS. Who is that, Joe Flom?

Mr. MERCER. Yes.

Mr. PICKENS. Yes.

Mr. MERCER. He is quite a guy. [Laughter.]

Senator METZENBAUM. We do not advertise lawyers here at this hearing. [Laughter.]

Mr. MERCER. Senator, what I would like to address because I think it is an important point, and Mr. Pickens states it quite well, is this business about the little one getting the big one is un-American.

If you would allow me a couple of minutes, I would like to show you a wiring diagram of what a little one is all about when he goes after a big one. May I do that, please?

Senator METZENBAUM. Sure.

Mr. MERCER. I would like to have Ms. Hyde point out the diagram for me as I just read quickly through this.

Last October and November when Jimmy Goldsmith and his entities threatened this takeover of Goodyear, there was no Hart-Scott-Rodino filing, and this occurred despite the fact that two of the Goldsmith entities bought more than 12.5 million shares of Goodyear common stock, for which they paid more than a half a billion dollars.

Now, no filing was made because the two entities that bought that half billion dollars' worth of Goodyear stock were newly formed partnerships, a Bermuda limited partnership and a Delaware limited partnership.

The identities of the limited partners in those two partnerships were never disclosed. The general partner of each was a newly formed corporation, one a Delaware corporation and the other a Cayman Islands corporation. Both of these were owned by a second Cayman Islands corporation, which was owned by a third Cayman Islands corporation, which was controlled by two interlocking Panama corporations.

Now, this trail ends at a Liechtenstein trust which controls the Panama corporations. The identities of the principals behind that trust are kept hidden under Liechtenstein secrecy laws, but those principles could be anyone, even a worldwide tire company or maybe some other competitor of Goodyear.

None of these entities filed a pre-merger notification report. Under the Hart-Scott-Rodino pre-merger notification rules, partnerships are not considered to have ultimate parent entities, so that neither Brunneria, which was the Liechtenstein trust, nor any of the shell corporations and holding companies by which the partnerships were, in fact, controlled had to file pre-merger notification reports.

As newly formed partnerships without assets beyond money and Goodyear stock, the Bermuda and Delaware limited partnerships did not have to file either. Although the antitrust authorities could read in the papers that Mr. Goldsmith, who is an Anglo-French financier and well known corporate raider, was trying to take over Goodyear, none of the information ordinarily supplied as part of pre-merger notification was filed with them.

No one knew then, or really knows now, who or what lay behind that labyrinth of offshore holding companies and corporate shells. Neither the holders nor the holdings of Brunneria, a peculiar form of legal entity called an anstalt, have been disclosed in any way.

Senator METZENBAUM. Mr. Mercer, you have convinced me, but there are many of my colleagues on this side of the aisle, which I would guess is the side of the aisle where you have normally voted during your lifetime—and I respect you for that; you have the right to be wrong. [Laughter.]

I would say to you that we are prepared to move to close the loophole. The argument is being made that the FTC will take care

of it, but their proposal would be that there would be no filing unless the partner has a 50 percent or more position.

Now, you do not have to be a genius to figure out a way to fancy-dance around that one, particularly when you are playing with these off-island corporations and Liechtenstein corporations.

I would strongly urge you to discuss with your colleagues and friends at the Business Roundtable and the Chamber of Commerce and the NAM that it is time that they deliver a few votes on this issue and we will move this subject.

But this idea that the FTC is going to take care of it, in my opinion, is unadulterated hogwash. It will not happen soon enough and I think we can move it, but we need a little help.

Mr. MERCER. I will give you all the help I can because I agree with you; it is not going to occur that way.

Senator METZENBAUM. Thank you.

Mr. PICKENS. How are you going to take care of it?

Senator METZENBAUM. How would we—

Mr. MERCER. Get the votes he needs for the legislation?

Mr. PICKENS. No. I mean, what kind of legislation are we going to have that is going to take care of this situation?

Senator METZENBAUM. Well, we are talking about the requirement of a partnership to make a disclosure. We are talking about the fact that Sir James Goldsmith was able to get around the—

Mr. PICKENS. Why do we let the FTC take care of it? The five percent on the 13(d) catches it.

Senator METZENBAUM. Because the FTC would provide that you only would have to—you would not have to make a filing unless one of the partners owned a 50-percent or more position.

Mr. PICKENS. But you get caught on the 13(d) filing, Senator, so it would kick in long before, of course, you would go to 50 percent.

Senator METZENBAUM. Let me just ask my staff why that will not solve our problem.

He points out that the 13(d) does not provide for any antitrust review at all. Do I understand you, Boone, to be saying that you would be opposed to closing this loophole?

Mr. PICKENS. Well, I do not see that it requires legislation. I am supposing that the FTC can close that loophole by just saying that the partnership—the way I would see the FTC closing it is just saying that they are notified the same time the SEC is on the 5-percent 13(d) filing.

But you will get caught by antitrust review by the—I do not know why I am stumping for this because we never have a problem on antitrust anywhere; we are not big enough to. But where I would see that review would come would be in the final—just like Chevron acquiring Gulf; it caught FTC review.

Senator METZENBAUM. Well, of course, there you have got more of an antitrust issue. Mr. Sommer, who is an expert in this area, will be one of our witnesses shortly. We are going to let him address himself to this rather than to get our corporate executive, our corporate, whatever you call yourself, author—

Mr. PICKENS. I am not a lawyer; that is for sure.

Senator METZENBAUM. Author.

Mr. PICKENS. Well, I mean I do not understand some of these legal ramifications here, but I hate to see anything complicated by

legislation. If you can catch it over under the Williams Act and the SEC, I mean let us do it over there and not get the Hart-Scott—

Senator METZENBAUM. Let me tell you that I am not in favor of passing legislation unless we need to, but the facts are that there are enough occurrences in recent years that the FTC has not moved on, and I think our action is just an indication that we are not satisfied, A, that they are moving effectively, and, B, that they are moving rapidly enough.

If they will do it, and if they do it before we pass the legislation—I have already said this publicly—then we will back off because if they achieve our aim by regulation, that's well and good. But at this moment it is still in the discussion stage, and although it is moving, it is not moving as rapidly as I would hope. If we can pass a bill, we are going to pass it.

Gentlemen, thank you very much. We have other witnesses. I do have some further questions for all of you, but I am a little bit concerned about the time. It is 10 to 12 and I am afraid I am going to foreclose the opportunity to get these other witnesses on. I apologize for the fact—I guess I do not apologize—I am sorry about the fact that we had two roll calls that took up about 45 minutes of our time.

Thank you very much. We will be submitting some questions to you.

Our last panel consists of James Martin, Chief Investment Office of the College Retirement Equities Fund, and Al Sommer, Morgan, Lewis and Bockius. We are happy to welcome you, and I am happy to see you again, Al, a personal friend of many years. We are glad to have you with us today.

Mr. Sommer, why do you not proceed first? You know about our 5-minute rule.

STATEMENT OF A PANEL CONSISTING OF A.A. SOMMER, JR., PARTNER, MORGAN, LEWIS & BOCKIUS; AND JAMES S. MARTIN, EXECUTIVE VICE PRESIDENT AND CHAIRMAN, FINANCE COMMITTEE, COLLEGE RETIREMENT EQUITIES FUND

Mr. SOMMER. Very well, Mr. Chairman. First of all, I would like to commend you for having these hearings. This is a terribly important issue that has been put into sharp focus by the disclosures that have been made with regard to the insider trading that has attended much takeover activity, and there are indications that other abuses have existed that are going to be disclosed in proceedings that will be forthcoming.

Let me say in brief summary that it seems to me that it is terribly important that tender offers be regulated in a fashion that will be fair to all shareholders. Any system of regulation in this area must have two characteristics. One, it should see to it that everyone is fairly informed with regard to everything they need to know in order to make sensible investment decisions. And the second thing is that there should be fairness with regard to all of the players on the field and not just fairness to those who happen to be big.

Regulating tender offers is not easy, Mr. Chairman, because there are ingenious minds that are constantly at work trying to find ways of evading the strictures that Congress intended. A good

example is the present section 13(d) of the Securities Exchange Act of 1934.

Section 13(d) was intended to provide prompt disclosure of the accumulation of stock, so a 10-day notification provision was put in; that was in 1968. Since then, there has been a tremendous increase in the liquidity of markets, a tremendous increase in the ability of investment bankers to accumulate stock and engage in block trading, with the result that now you can have tremendous accumulations of stock before there is ever a filing required.

I had dinner the other night with the CEO of a company that had been acquired and he said the first indication he had that anybody was accumulating stock was when a form 13(d) was filed that disclosed a 20-percent holding. Of course, by that time the ballgame was pretty well over.

Looking at these things in terms of what I call disclosure and fairness, and I do not think anyone can argue with either one of them, certainly closing that so-called 13(d) window, as you have proposed, is in order.

There should also be, I think, a reduction in the filing threshold because when the threshold is five percent, everyone who sells into the market to the person who is doing the accumulating is denied the opportunity of getting a premium that should be shared by everybody. This number should be made as small as possible, say 1 or 2 percent.

I think that the ten days should come down to 24 hours, and I think it would be a good idea to provide that there should be no accumulation of stock during the 48-hour period following the filing, so that that information can be disseminated broadly to all shareholders.

Secondly, it seems to me that there should be severe penalties for people who do not file or file false information. One of the practices has been for filings to state that an accumulation is for the purpose of investment. As soon as there has been a sufficient accumulation, it becomes apparent that that was an absolute falsehood and that the purpose was really either to extract greenmail or to initiate a tender offer, or to put the company "in play." As a matter of fact, Mr. Pickens was plucked off base, if you would, with regard to that very matter by a federal court.

With regard to fairness, it seems to me the practice of "sweeping the streets" should be eliminated. This is a practice where by a tender offer is initiated and then was terminated without buying any stock. Meanwhile, arbitrageurs pick up enough stock to control the company. In one case the bidder terminated the tender offer and then bought from one holder enough stock to control the company; in the other case, the bidder bought from six holders. That is unfair to those shareholders who intended to tender or had tendered, because the premium did not go to them; it went to those large shareholders.

It seems to me that your proposal to require that after a certain threshold acquisitions should only be pursuant to a tender offer is a sensible way to save this problem.

Another reform that is badly needed is to broaden the concept of group. There is evidence that there has been a good deal of collaboration among some institutions—I am sure not CREF—some insti-

tutions and bidders, and I think it is important that there not be tolerated any longer such things as warehousing stock and collaboration and accumulation.

Senator METZENBAUM. What would you do about warehousing of stock? How would you prohibit that?

Mr. SOMMER. I think that a broadening of the concept of group and requirement of disclosure with regard to discussions that bidders engage in with institutions and other holders, plus a severe penalty associated with false filings, is about the only way you can come to grips with it.

Senator METZENBAUM. You are using a word that I am not picking up. Did you say group? I do not get the word.

Mr. SOMMER. Group.

Senator METZENBAUM. G-r—

Mr. SOMMER. G-r-o-u-p.

Senator METZENBAUM. I do not know that phrase, I am sorry to say.

Mr. SOMMER. Well, that phrase is used presently, Senator, in the section 13(d) to describe anyone that acts in collaboration with an other in connection with the acquisition, voting, and holding of stock. It should be defined somewhat more broadly and there should be a regulation requiring disclosure with regard to conversations and communications that occur between certain shareholders when someone is accumulating stock preparatory to a bid or simply acquiring it for purposes of control.

It should be broadened for the purpose of making sure there is better control of this practice of a wink and a nod that results in someone other than the bidder accumulating stock which is available to the bidder if he is seeking control.

Senator METZENBAUM. We would be happy to work with you both with respect to language that pertains to warehousing and to group.

Mr. SOMMER. We will be pleased to do that, very good.

As you have proposed in your legislation, the period that a tender offer must remain open should be extended. Individual shareholders do not move quickly. The institutions move promptly; big shareholders move promptly.

The fellow out in your State and my State who does not have a lot of experience with stock markets is not sufficiently alert to what is happening day after day in the market, and oftentimes he will be somewhat sluggish, if you will, in responding. I think he should be given a fair opportunity.

Senator METZENBAUM. How often does it happen that the small shareholder has his stock in street name at his broker and actually never gets to know about the offer until maybe way late in the game? How does that work as a practice?

Mr. SOMMER. Well, brokers typically, Mr. Chairman, are pretty diligent about informing the beneficial owners of stock they hold as nominees. It is the fellow who tucks it away in the safe deposit box that very often is the one who does not move promptly and does not receive adequate notice.

Now, he gets a mailing. He knows it, but it is easy for people to overlook deadlines and that sort of thing. I had a recent experience myself when I suddenly realized that a security that I held which

had been tendered for in an LBO. The deadline was quickly approaching and all of a sudden I had to move like the devil to make sure that I got the tender offer documents in. I think I am a little bit sophisticated, but nonetheless time does run out on people.

There was an example in connection with the acquisition by USX of Marathon where there was a two-tier offer, with the first tier price substantially above the price of the second. In that case, several billion dollars accrued to the benefit of institutional and large investors because the individual investors do not take advantage of the tender offer in time. So there is evidence, clearly, that the present tender offer limitations can prejudice individual shareholders.

A further matter—and I do not think this is in your bill, Senator—is that I think bidders should not be permitted to bid for stock or to indicate that they may make a bid unless they have their financing firmly committed.

By making it so easy to get a letter stating that the investment banker is highly confident that he can secure the financing, it makes it very easy for someone to put a company into play and seek greenmail or hope that another company comes in, makes a bid, takes him out a premium, and he has never even paid a commitment fee to get financing. I think something should be done about that.

Senator METZENBAUM. If you have some language on that, we would be interested, also.

Mr. SOMMER. Yes.

Furthermore, Mr. Chairman, I would fully agree that there have been abuses on the part of management in this process, but I think it is important that if management is to be restrained with regard to activities like greenmail, that must be done in a context in which the bidders are similarly restrained from tactics that are questionable and unfair.

But I would like to make one other comment. It seems to me that there is a basic flaw in all of the activity that we are talking about here, and it has been demonstrated very dramatically in the GenCorp case.

The GenCorp case was not a poorly managed company. Since it has had new leadership, it has been dramatic the way that it has been turned around. As a matter of fact, the market has been highly complimentary to the present management.

The Wall Street Journal, on March 26, 1987, said, "In the process"—this is Mr. Reynolds—"In the process, he has dramatically increased the value of its stock, the best defense against a hostile tender offer." But he is facing a tender offer today. Why?

Simply because—and this article is clear evidence of it—simply because of the fact he did not hock that company to the hilt so that he could go out and buy the stock of the company and drive the price up even further. That is what supposedly businessmen should be doing today. They should be doing everything they can not to run the company efficiently and competitively, but to drive up the price of the stock here and now.

I would like to close, Senator, by reading two paragraphs from this article, if I may.

To ward off the AGF partnership, as well as other suitors, Mr. Reynolds could employ several strategies—remember, this is a successful CEO—but each carries risks. He could, for instance, sell certain assets, including Aerojet General's aerospace unit, and distribute the cash proceeds to shareholders as part of the restructuring. But that tactic would hamper GenCorp's future growth.

Analysts predict that Mr. Reynolds will try to avoid surrendering important businesses. More likely, they say, he may seek to finance a major stock repurchase with borrowings, in the hope of driving the stock price out of the raider's reach.

Good, solid, effective businessmen in this country are being driven, by their desire to protect their employees, the communities they live in, and to protect the long-term interests of the shareholders, to tactics that have one purpose, and one purpose only—drive the price of the stock up now.

Mr. Chairman, I think restraints must be placed by this Congress in order to stop once and for all the tactics that have characterized tender offers.

Thank you very much for your time.

[The prepared statement follows:]

Statement of A. A. Sommer, Jr.
Before the
Antitrust, Monopolies and Business Rights Subcommittee
of the
Senate Committee on the Judiciary

Mr. Chairman and members of the Subcommittee. My name is A. A. Sommer, Jr. I am a partner in the law firm of Morgan, Lewis & Bockius, Washington, D.C. From 1973 to 1976 I was a Commissioner of the Securities and Exchange Commission.

First, I would like to thank you for the opportunity to speak to you today. The subject which you are addressing in this hearing is one that has for a long time been an important one, but one which has taken on new importance as a consequence of the tawdry disclosures of the way in which the tender offer process has been abused by investment bankers, lawyers, arbitragers and others involved in the process. While thus far the most dramatic disclosures have related to insider trading, there have been indications from a number of sources that the inquiry is widening, and that other kinds of abuses have occurred and will quickly claim the spotlight.

While a telling case can, in my estimation, be made for the proposition that hostile takeovers have no place on the American economic scene, and that all the vaunted benefits that supposedly accrue from them are specious myths, the option of outlawing them is not an option being considered in Congress today. The attention of this Subcommittee and other bodies considering these matters is focussed rather upon how all tender offers, including particularly hostile ones, can be regulated to protect the interests of shareholders, especially the individual ones who do not have the sophisticated expertise to play the arbitrage and other games attending tender offers, but whose presence and confidence in our financial markets is vital to their liquidity and prosperity.

Regulating tender offers is not easy, Mr. Chairman. The history of hostile tender offers in this country has been characterized by vast ingenuity on the part of investment

bankers, bidders, arbitragers and their lawyers in manipulating regulations to their advantage, and you may be sure they will quickly seek means of undercutting the thrust of any new rules. A clear example of their cunning is the way in which section 13(d) of the Securities Exchange Act of 1934 has been subverted. It was designed to provide the market-place with timely information concerning accumulations of stock that might precede an effort to acquire control of the issuer. It provides that anyone acquiring more than 5% of a class of equity securities of an issuer registered under the 1934 Act has to report his holdings within 10 days of passing the threshold.

Players of the takeover game, aided by an increasingly liquid market, quickly discerned that much more than 5% of a class could be acquired before disclosure had to be made. So we began to see filings on the tenth day reflecting holdings well in excess of 5% as the result of substantial purchases during the ten day period before the report was due. Thus was the salutary purpose of section 13(d) subverted and innumerable shareholders sold out without knowing someone with a possible takeover intent was in the market buying, and so missed out on any premium over market that emerged.

Another example. In at least two instances bidders have commenced tender offers, then terminated them and immediately thereafter bought up enough stock to control the issuer, in one case from half a dozen large holders, in another from a single seller. And what of those holders who had tendered or expected to tender? They were left high and dry while the arbitragers and the other professional players reaped the harvest.

In considering measures which might be taken to sensibly regulate tender offers, the watchwords should be disclosure and fairness.

Disclosure is at the heart of the federal system of securities regulation and it is at the heart of sound markets. The fairest market is the one in which all the participants have

the same opportunity to secure information material to their investment activity and to make judgments on the basis of that information. It is fundamental that when anyone has embarked upon a course of accumulating stock, those in the market should know quickly of that intention and they should be able to rely on the information the acquirer gives them. Thus Congress must close the notorious "13(d) window" by requiring disclosure within 24 hours after someone passes the threshold of ownership, and no further acquisitions should be permitted until investors -- not just the institutions, but all investors -- have secured, and assimilated the significance of, the information. Forty-eight hours from the time of filing is probably an appropriate period to achieve this.

What should be the threshold? Mr. Chairman, the Panel on Take-Overs and Mergers in London, which has had 19 years of dealing with these matters day after day, has recently lowered the threshold for reporting ownership to 1%. I would suggest we learn well from them and adopt a similar threshold.

Obviously exceptions will have to be carved out for a number of acquirers and circumstances. I would suggest that in carving exceptions Congress should not be too quick to exclude totally institutional investors from more stringent filing requirements. At present certain institutional investors must file quarterly with the SEC reports with respect to holdings. Since there is a suspicion that some institutions may have been willing accomplices of bidders in accumulating shares, consideration should be given to tightening up disclosure requirements for institutions.

Disclosure is only helpful if it is truthful. There is ample evidence that many filings under section 13(d) have been less than candid. It is almost ritual for a first filing by an acquirer to state the purpose of the acquisition is "investment," after which, when the real intention is too evident to deny, disclosure of the true purpose -- a takeover -- is made. Even

when the purpose is stated as securing control or making a tender offer the truth may be different: it may really be to exact greenmail or put the company "in play."

Congress should consider severe penalties for both late filings and for filings that lack candor and truth. Perhaps an appropriate penalty in both cases would be withdrawal of the right to vote the stock for a specified period, or perhaps monetary penalties might be imposed.

Measures should also be adopted to assure fairness to all shareholders. The strengthened disclosure requirements discussed above will in some measure assure fairness. But more is needed to outlaw some of the contrivances that have been used to favor one group of shareholders over others.

As mentioned, when a tender offer is terminated and the bidder then "sweeps the street," those who took the tender offer at face value and either tendered or forewent selling into the market because of an intention to tender are at the mercy of the bidder who, having bought control from the arbitrageurs and institutions, can deal with the remaining shareholders pretty much as he wishes. At a minimum he is under no obligation to give them the same price he paid for the controlling shares he bought. "Sweeping the street" should be banned or made so costly no one would engage in it. Various means have been suggested: forbidding purchases for a significant period after termination of a tender offer before its expiration date; requiring any profit realized on the sale of stock bought in advance of the tender offer to be disgorged to the issuer; disenfranchising stock bought in the "sweep" for some period.

Along a similar line, when someone has acquired more than a specified percentage of a class of securities of an issuer, say, 10 or 20%, any further purchases should have to be made pursuant to a tender offer extended to all shareholders. This would assure that at least those shareholders who did not sell out during a bidder's push to the threshold would all have

an equal opportunity to share in any premium the bidder was willing to offer. This requirement might well be extended to require that such an offer be for all the outstanding stock, thereby eliminating the coercion that is inherent in partial offers and assuring that a bidder does not leave shareholders as minority holders in an enterprise managed by persons other than those in whom they placed faith when they bought and kept their stock.

Congress should revisit the concept of "group" under section 13 of the 1934 Act. There is increasing evidence that in the course of tender offers there may have been "warehousing" of stock or other collaborations which were not disclosed in section 13(d) filings. Unless these joint ventures are adequately disclosed, the integrity of filings and disclosures is seriously compromised. It may be difficult to thwart the wink and the nod, but in some fashion the public should have measures of learning about such collaborative conduct.

Often individual shareholders are less sensitive to the pace and time constraints of tender offers and may act less nimbly than their professional brethren in responding to a tender offer. Further, not infrequently the best opportunity for shareholders may not be -- and often is not -- the first offer. Once a company is "in play" the only recourse of management and the board may be to, in effect, put the company on the auction block. To assure equality among individuals and institutional investors and to give management the breathing space to seek other avenues to afford shareholders maximum value, the minimum period a tender offer must remain open should be expanded beyond the presently required 20 business days. Selecting the precise period has something of an arbitrary quality about it, but I would suggest that doubling the present period would assure that individual shareholders would have ample opportunity to participate and management would be able to secure the best deal for shareholders.

Finally, bidders should not be permitted to commence a tender offer unless they have firm commitments from reputable institutions that funds are available to fund the offer. So-called "highly confident" letters provide no assurance that the money will be there when the offer is completed. While it may appear that no tender offer has aborted because of a bidder's inability to finance it, we don't know how often an offer has been commenced with no intention of its going through to fruition because the bidder really intended to exact greenmail or put the company "in play" so that it could sell its accumulation at a tidy profit. In such situations "highly confident" letters are a cheap way to start the bad faith bid. Congress should adopt a measure to require that bidders have firm commitments for financing, thus assuring to some extent that bids are bona fide and not disguises for base purposes, and that the putative bidders are truly bidders.

My suggestions are directed at the practices of bidders. In their zeal to head off an unwanted offer, managements, too, have sometimes engaged in practices that should be ended. It is the chant of the takeover fraternity that any effort by management to thwart a bid is simply for the purpose of "entrenching" management. That charge, Mr. Chairman and members of the Subcommittee, is, to use a trite phrase, a base canard. Often management fights the unwelcome offer to preserve the values, tangible and intangible, inherent in the corporation, to preserve the entity as a whole, to provide the opportunity to realize the long term potential of the company according to carefully developed plans. Two examples, Mr. Chairman, of well justified resistance to unwanted attentions have occurred in your and my home state. Both Goodyear Tire and Rubber and Gencorp were in the midst of well-conceived programs to realize value for shareholders consistent with the protection of employees and the communities in which they had facilities, as well as customers and suppliers, when they were suddenly confronted with bidders who acknowledged that they would grasp control of the company and get their "bait" back on the quick by dismantling the enterprise.

The undesirable practices of management at least have the merit in many instances of being born out of concern for the companies and their constituents and in response to the distortions embraced by bidders. But undesirable practices they are. Congress should address those, too, but only if the conduct of bidders is restrained appropriately.

It will be asserted, of course, by some that any restraint on the conduct of bidders is inimical to the "free market for control" of corporate enterprises. The attitude of these people was capsulized in the statement of two proponents of such a market that the control of corporations should be as freely tradable as apples. How shocking: to equate control of multi-billion enterprises like Gencorp and Goodyear with apples! The very comparison displays the insensitivity of some to the true nature of corporate endeavors in American life and American society.

The proponents of unfettered bidder activity contend that American management needs the "discipline" of takeovers to assure their performance. This assertion is patently specious. First, of course, most takeover targets are well-managed, profitable enterprise; in fact, one study determined that on the average targets have a 16% return on equity, a very respectable figure, indeed. Second, there are innumerable forces pushing managements to high performance. To take the most obvious, there is the fierce competition raging in every kind of enterprise. People in business tell me they have never known more intense competitive pressures. Any management that cannot keep pace with this world-wide struggle will be quickly identified and the independent directors, the company's investment and commercial bankers, business publications, the institutional investors in the company's stock, will supply ample pressure for management to either raise the level of performance or get out. Every day we read of CEOs being pushed out, and not because of a threatened takeover.

We are in a time of "instant gratification." What this desire will drive people to is made clear in some of the indictments being returned in connection with illicit uses of information in connection with tender offers. Another manifestation is the pressure on institutional investors to chalk up performances exceeding the indexes quarter by quarter lest they be branded as inferior managers. To them a tender offer is a bonanza, a powerful assist in achieving desired performance levels. But to some there is a troubling element. The head of a large mutual fund complex recently told me that it tore him up to feel compelled by his legal and fiduciary duties to accept a \$60 bid when the market was \$50, without being able to take into account the long-range welfare of the company.

This short term perspective has, of course, infected corporate management, too. The threat of hostile bids has compelled management to focus on maximizing the immediate price of their company's stock to the exclusion of virtually all other considerations. The Wall Street Journal last Thursday recounted the commendable and successful efforts of Gencorp management to rebuild the company, efforts that, in the Journal's words, "dramatically increased the value of its stock." But, the article continues, management failed to boost the price of the stock further by borrowing money to finance a buy back of stock. Management's sin? A commitment of the corporation's resources to its business and a prudent avoidance of the dangers inherent in a distorted debt-equity ratio.

If it is to avoid the destruction of the company and its well-laid and successful plans, Gencorp must apparently substitute short term "instant gratification" of its shareholders for its long range plans. I submit the glorification of immediate profit secured through financial manipulations at the expense of long term gains growing out of sound management is a cancer that is destroying the ability of American industry to compete effectively with the likes of Germany and Japan, two economies it is worth noting that are singularly free of hostile takeover activity.

In brief, what manager, confronting the Goodyear and Gencorp experiences, dares to plan for the long term prosperity of his business?

I would close with another suggestion, but without having anything very concrete in the way of proposals to implement it. We must re-examine the forces that compel institutional investors to become in effect allies of bidders. They must be freed from the compulsion they feel to put "instant gratification" ahead of the long term interests of the companies in which they invest.

In the last week we have witnessed, I hope, the beginnings of the process of consensus-building with regard to this problem. The Securities Industry Association, which was relatively mute during the efforts in 1985 to develop legislation concerning tender offers, has announced its support for legislation in this session of Congress. Some of its proposals are consistent with those I have stated and those contained in S. 678 which you have introduced, Mr. Chairman. This action by the SIA bodes well for the future of responsible legislation in this important area.

Again, Mr. Chairman and members of the Subcommittee, thank you for this opportunity to express the deep concerns I have with practices I believe are having a severe disruptive effect upon American business and imperiling the prosperity of our country. I am sure that out of these hearings will come solutions that will abate this threat.

Senator METZENBAUM. Thank you, Mr. Sommers.

Mr. Martin, are you accompanied by the gentleman next to you?

Mr. MARTIN. This is Mr. Clapman, who is with our firm, yes.

Senator METZENBAUM. He is with you. I just wanted to know who the players were. We are happy to have you.

Mr. MARTIN. Thank you very much for the opportunity to comment on some of the issues before the committee. I will try to be as brief as possible.

Senator METZENBAUM. Bring the mike closer to you, please.

Mr. MARTIN. Perhaps I should take a moment addressed to describing who we are. The College Retirement Equities Fund, or CREF, as we are generally known, is the equity component of the nation's largest private pension system. Together with our affiliated company, the Teacher's Insurance and Annuity Association, TIAA, we invest the pension contributions of about a million employees of U.S. colleges and universities and related non-profit educational organizations.

The combined assets of the company approach \$58 billion, of which CREF has about \$30 billion, plus or minus a billion as each day passes, it seems.

Senator METZENBAUM. Between friends, that is not much.

Mr. MARTIN. CREF is invested entirely in common stocks, mostly in the stocks of U.S. corporations, roughly 1,500 of them. We think we are probably the largest single equity portfolio in existence and, of course, we are a large shareholder in most major corporations.

As a large shareholder, we take very seriously our right and our responsibility to speak out on matters which affect the value of our investment and the interests of those who have committed their pension contributions to us.

We believe that we are in a unique position to speak out about issues that concern large and small shareholders alike, since we both have a common interest in long-term corporate welfare.

I would like to point out that institutional investors are concerned with the long-term interests of corporations and not just in short-term profits. In CREF's case, our investments are held for the long-term—most of them have been held for at least five years, many for as much as two decades.

We spend a great deal of our time trying to assess the long-term earnings and dividend potentials of the portfolio companies that we own, and those interests extend well beyond the next quarter or the next year.

I would also submit that, in general, the evidence shows that institutional ownership has been beneficial to the long-term interests of corporations. For example, companies with large institutional ownership tend to spend more on long-term R and D than do other companies.

The current takeover environment has been marked by rapid change as various techniques have been employed by individuals or organizations on both the offensive and defensive sides of the issues.

Shareholders, however, and even large ones such as CREF, are often left out of the calculation. CREF's preferred approach, of course, is to allow natural market forces to regulate conduct. Legis-

lation can often have unforeseen results and require additional legislation to rectify.

We have, therefore, started our analysis by asking the fundamental question whether legislation in this area is appropriate now, and if so, whether it should be at the Federal or State level.

We have concluded that Federal legislation is, in fact, appropriate for a number of reasons, and I will not go into them because we are running short of time; I think they are obvious.

But let me say that with respect to legislation that we would comment on, we wholeheartedly support a prohibition against the payment of greenmail. We feel it is a practice that benefits only raiders and managements seeking to entrench themselves.

We would support reducing the so-called window reporting period after an acquiror has purchased 5 percent of a company's stock, and reduce the period from 10 days to 1 day. We think the current rule, again, only benefits raiders.

We find the poison pill to be a particularly troubling device and would strongly support legislation addressed to it. However, we question whether the pills should be outlawed altogether. We would, however, support legislation to require submission of a poison pill to a vote of the shareholders. Anything that so fundamentally affects their rights and their relationships to management, I think—

Senator METZENBAUM. As such a large stockholder in so many companies, have you ever taken any legal action or steps to attempt to prevent the payment of greenmail or the development of poison pills?

Mr. MARTIN. On the subject of greenmail, we have looked into the possibility of a lawsuit. We have discovered that the business judgment rule is pretty strongly entrenched and that there really is no future in undertaking such a suit.

That really does require legislation. There is no legal remedy as far as we are concerned.

On the subject of poison pills, we have initiated proxies this season with ten companies, requesting those managements to submit the poison pills that are in place to the shareholders, and we are in the process of supporting those proxies right now.

Senator METZENBAUM. Are you being resisted in that effort by management?

Mr. MARTIN. In a word, yes. Managements, of course, refer to poison pills as shareholder rights. We hardly see what right it is we have acquired and what value those rights have since we have basically given to managements, on a unilateral basis, the ability to decide whether or not our company can be sold at a price that is being offered. I mean, we have basically forfeited, or had forfeited for us, our right to determine at what price to sell our company. Shareholders are the owners, after all.

With respect to other proposals, we, of course, would favor anything that eliminates the disparity that may exist between large and small shareholders. We are not certain that eliminating the partial two-tier offer, in fact, will achieve that parity, but I do not think we would object to having such legislation.

As the SEC has commented, there is little evidence that individual shareholders have, in fact, had difficulty participating in offers.

I was not aware that the number was 90 percent. I am not sure 90 percent is enough. That means 10 percent of shareholders are left out of the equation, and I think that perhaps needs remedy.

Senator METZENBAUM. I might say that there are others who question that 90-percent figure on the part of the SEC.

Mr. MARTIN. We are a large institution and it is a fact that in offers such as the Marathon and the Conoco offers, which were part cash, part securities, there is no question that we institutions, and CREF, in particular, came out better than the average shareholder by virtue of submitting all our shares to the cash portion of the offer and receiving somewhat more than the proportion of cash in the offer. So it means somebody was left out somewhere.

As to the proposal to extend to 60 calendar days the period during which a tender offer must remain open, I think our attitude is that seems a bit extreme. I think we have to worry about the kinds of defensive tactics that might be implemented, given that broad a window.

But we would not object to something between the two, and our thought would be perhaps 30 business days would be a reasonable alternative. Again, that is not an issue on which we feel very strongly, but we think perhaps some study there would make some sense so that we have a better feel for what a right number is. I do not think we have done that.

I would be happy to address your questions.

[The prepared statement and response to questions follow:]

TESTIMONY BY JAMES S. MARTIN,
EXECUTIVE VICE-PRESIDENT AND CHAIRMAN,
FINANCE COMMITTEE, COLLEGE RETIREMENT
EQUITIES FUND, BEFORE THE SENATE ANTITRUST,
MONOPOLIES AND BUSINESS RIGHTS SUBCOMMITTEE
OF THE JUDICIARY COMMITTEE, APRIL 2, 1987

We are pleased to be given the opportunity by the Senate Antitrust, Monopolies and Business Rights Subcommittee of the Judiciary Committee to express our views on the critical issues raised by the current corporate takeover and tender offer environment.

Before we get into today's subject of corporate takeovers and responses to them, it may be helpful for those of you who don't know us to have some background on the company I represent.

The College Retirement Equities Fund -- or CREF as it is generally known -- is the equity component of the nation's largest private pension system. Together with our affiliated company, the Teachers Insurance and Annuity Association -- TIAA -- we invest the pension contributions of about one million employees of U.S. colleges and universities, and related non-profit educational organizations. TIAA-CREF's assets exceed \$50 billion, and CREF itself has more than \$25 billion invested in the common stocks of 1500 U.S. companies. CREF's equity portfolio is one of the largest in the United States, and we are among the largest shareholders of many American corporations.

As a large shareholder, we take very seriously our right and our responsibility to speak out on matters which affect the value of our investments and the interests of those who have committed their pension contributions to us. We believe that we are in a unique position to speak about issues that concern large and small shareholders alike, since both large and small shareholders share a common interest in long-term corporate welfare. In this regard, we should point out that institutional investors are concerned with the long-term interests of corporations, and not just short-term profits. In CREF's case, most of our portfolio represents investments that we have held for at least five years. We

spend a great deal of time trying to assess the earnings potential of our portfolio companies beyond the next quarter or the next year. In general, the evidence shows that institutional ownership has been beneficial to the long-term interests of corporations. For example, companies with large institutional ownership tend to spend more on long-term research and development than other companies.

The current takeover environment has been marked by great change, as various techniques have been employed by individuals or organizations on either the so-called "offensive" or "defensive" side of the issues. Each move on one side has often been matched by a move on the other side to maximize their relative positions of the moment. Shareholders, however, even large shareholders like CREF, are often left out of the calculation.

CREF's approach to legislation is first to allow natural market forces to regulate conduct. Legislation often can have unforeseen results that subsequently require additional legislation to rectify. We have, therefore, started our analysis by asking the fundamental question whether legislation in this area is appropriate now, and if so, whether it should be on the federal or state level.

We conclude that federal legislation is appropriate for a variety of reasons. First, we agree that there are abuses beyond the ability of the market to control, with the risk of continued adverse consequences to shareholders. The legislative aim should be to adjust the tender offer process so as to deal with these abuses -- whether they be on the side of a corporate raider seeking to put a company "in play" so as to make a quick turnover profit, or a target company management seeking to entrench itself and insulate itself from any offers to acquire the company -- while maintaining the neutrality and balance which we believe is essential to protect large and small shareholders alike.

We also believe that, since the tender offer is a transaction which is nationwide in scope and impact, the

problems pertaining to it are necessarily nationwide in dimension. We believe that the problems are systemic ones, so that they cannot be dealt with on a patchwork or piecemeal basis by the courts. Nor can they effectively be dealt with by state legislative initiatives, which are likely to be inconsistent and incomplete, even assuming that a large number of states could be prodded to take action. Federal legislation appears to be the only effective alternative, and also seems to us to be necessary to restore a somewhat shaken public confidence in the tender offer and those who participate in it. We continue to believe that the tender offer is largely a beneficial transaction for shareholders -- one that has brought far more good than harm to this country's shareholders. Curative federal legislation now seems necessary to preserve these benefits.

There are practices in the takeover arena which we think deserve -- and now appear to receive -- virtually universal condemnation. We have been active for some time in attempting to obtain federal legislation against the pernicious practice of greenmail -- a practice which benefits only corporate raiders and incumbent managements seeking to entrench themselves -- and continue to believe that there is no valid argument whatever against such legislation. There also appears to be virtually uniform support for reducing the so-called "window" reporting period after an acquiror of stock has purchased 5% of a company's stock from ten days to two days or even less. We wholeheartedly support legislation in this area, since the present 10-day period benefits only raiders who are often seeking some kind of greenmail payment.

We find the poison pill to be a particularly troublesome device, and strongly support corrective legislation addressed to it. We are not certain that federal law should outlaw the poison pill itself as a substantive matter. But we do believe that a device of this fundamental impact on all shareholders should be approved by shareholders, rather than unilaterally imposed upon them by their company's management,

and we vigorously support legislation that would prohibit poison pills unless approved by shareholders.

Poison pills, in our view, deprive shareholders of their basic right to evaluate for themselves offers for their shares; and -- by preventing offers that might be beneficial to shareholders -- they reduce the value of the company's stock. By the use of poison pills, managements assume an authority that they have never had in the past: to decide who should or should not own the company. Poison pills deprive shareholders -- the owners of the corporation -- of their fundamental right to decide for themselves whether to sell or hold their stock, and who should control their corporation. As recently stated by a Court of Appeals which invalidated a poison pill, such a device "effectively precludes a hostile takeover, and thus allows management to take the shareholders hostage. To buy (the company), you must buy out its management." Defensive tactics such as poison pills, said the court, often leave shareholders "defenseless against their own management."

The economic evidence against poison pills is well documented in a recent study by the SEC Office of the Chief Economist. This study examines all 245 poison pills adopted from 1983 through July 4, 1986 and finds that share prices have, on average, declined relative to the market at the time of the announcement of a poison pill's adoption. The study further concludes that the loss to shareholders in companies with poison pills which have successfully prevented attempted takeovers has outweighed the gains in other companies with poison pills which were ultimately taken over. Of course, no study can document how many bids at higher prices were never made because of a poison pill. Prospective bidders will be far less willing to undertake the effort and expense of mounting a bid in the face of what the SEC has described as the "lethal" effects of the pill.

We know that there are those who favor the poison pill, or believe that it should not be singled out for

legislative attention. As we noted, we do not contend that all poison pills should be outlawed as a substantive matter by federal legislation. But we do believe that it is appropriate to require that they be approved by the shareholders they are supposedly designed to benefit, and we can see no legitimate policy argument to the contrary. Indeed, we can think of no rational reason why the management proponents of poison pills have been unwilling to test their arguments in favor of these devices before the shareholder constituents which they purport to represent, except for the fear that shareholders will vote to forego the dubious "protections" and euphemistically named "rights" that their managements seek to encumber them with.

We also believe that poison pills stand on a far different footing from the other varied defensive transactions which a target company may undertake without shareholder approval in the heat of a takeover battle, and which can appropriately be policed by the courts. For one thing, poison pills are far more pervasive in sheer numbers than other defensive measures, with hundreds of companies having adopted them within the last few years. Moreover, poison pills are ordinarily adopted before a takeover struggle is underway, so that there is usually more than sufficient time to seek shareholder approval. Poison pills are, in sum, a unique and special phenomenon that we believe deserves special attention.

We also believe that there is no other way to accomplish the desired result of requiring shareholder approval of poison pills than by federal legislation. The courts are not in a position to impose any such requirement, which is essentially legislative rather than judicial in nature, although it is significant that poison pills have come under increasing judicial criticism. It is also unrealistic to expect the disparate state legislatures to take consistent and meaningful action. Congress, therefore, remains the only realistic recourse for reform.

We are also cautiously optimistic about legislative initiatives in the area of two-tier, partial and "creeping" tender offers, although we believe that further study is necessary to clarify the economic impact of certain of these transactions. Certainly, we would favor any measure that eliminates any disparity that may exist in practice between the small shareholder and the large institutional shareholder; all shareholders should have an equal opportunity, in practice as well as in theory, to take advantage of any tender offer that is made. Indeed, CREF believes it has a special responsibility in approaching a legislative solution of the kind under discussion. We are a large shareholder with an experienced staff capable of evaluating market news and decisions to be made in the face of an offer for a company in which we own stock. We nevertheless recognize that an appropriate legislative solution must address the needs of small as well as large investors.

We are not at all certain that it is necessary to ban all partial or two-tier offers to achieve this parity. We do not know, for example, the extent to which partial or two-tier offers have actually resulted in inequities between different types of shareholders; the SEC has recently concluded, for example, that partial offers serve many legitimate business purposes and that "there is little evidence that individual shareholders have had difficulty in participating in offers for less than all the shares." The SEC has also concluded that two-tier offers have diminished to such an extent that any problems which they may have previously presented are now minimal. It may well be that two-tier offers have not in fact harmed shareholders as a group because they have provided a substantial premium to shareholders, a premium that would not exist if no bid at all were made or if a bid were frustrated by the target company. Certainly, if after appropriate study inequities are found in these transactions, they should be corrected.

We see no useful purpose in the "creeping" tender

offer or "street sweep," which benefit primarily the professional investor or arbitrageur. In fact, we have found that even with our substantial resources, we have been unable to benefit from "street sweep" situations, and the small shareholder is left out in the cold altogether.

We are more skeptical of proposals to extend to 60 calendar days the period during which a tender offer must be outstanding. As we noted earlier, we believe that tender offers generally have been beneficial to shareholders, and we want to see them continue. If legitimate bidders believe that their chances of ultimately acquiring a target company were substantially reduced by having such an extended period -- because, for example, of the greater time available for the implementation of defensive tactics -- tender offers might be substantially deterred in the first instance. On the other hand, at least some extension of the period would give target companies additional time to maximize shareholder value. Perhaps some period of time in between the present 20 business days and the proposed 60 calendar days might strike the proper balance.

We are also skeptical about an outright prohibition of what the present bill under consideration characterizes as "defensive tactics." It is difficult to categorize and evaluate in advance the types of substantive transactions which might be undertaken in response to a tender offer, and some of these transactions may actually increase the values available to shareholders. Buying back shares in the market and restructuring a company to make it more efficient can be positive steps of substantial benefit to shareholders, and we are not certain that the courts cannot provide sufficient protection against inappropriate and harmful transactions. We would, in any case, suggest further study in this area before sweeping prohibitions are enacted.

There have been abuses on both sides of the takeover process, and any legislative solution should both correct these abuses, and maintain the balance and neutrality necessary to

keep the process a viable one. Eliminating the perceived abuses on the raiders' side would, in fact, eliminate the purported justification for such devices as the payment of greenmail and the poison pill. As a major institutional investor, we believe that we can play a useful role in formulating appropriate legislation, and, as legislative initiatives evolve, we would appreciate the continuing opportunity to be involved in the process, and to share with you our views and our experience.



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May 14, 1987

The Honorable Howard M. Metzenbaum
United States Senate
Committee on the Judiciary
Washington, D.C. 205-10-6275

Dear Senator Metzenbaum:

Jim Martin asked me to respond to the questions included with your April 3, 1987 letter. We would have replied earlier but wanted to do certain additional research in order to reply properly to these questions.

(1) Your first question asks whether we agree with the specific provisions which you have proposed on greenmail, the ten-day window, and poison pills. With respect to greenmail, we did not see a specific provision on greenmail in the bill which you introduced in March of 1987. However, we would agree with and support the provision on greenmail contained in the bill introduced in the House of Representatives by Representatives Dingell and Markey on April 27. That bill prohibits a company from purchasing its securities at a price above the average market price of the securities during the 30 preceding trading days from any person who has held more than 3% of these securities for less than two years, unless such purchase is approved by a majority of the company's shareholders, or unless the company makes the same offer to all other shareholders.

With respect to the ten-day window, we are in agreement with your proposal that the ten-day period be reduced to one day. We do not, however, believe that it is necessary to reduce the 5% threshold to 3%, as your bill provides, and believe that, as in the Dingell-Markey bill, the 5% threshold should be retained. A lower threshold will, we believe, lead to many unnecessary filings for stock acquisitions which are not related in any way to a possible change of control. A possible alternative could be a lower threshold except for institutional investors who have no intent to seek control.

With respect to poison pills, we did not testify in favor of an outright prohibition of poison pills, although we would have no objection to such a provision. We do believe that poison pills should, in all events, be prohibited unless approved by the company's shareholders. In this regard, we believe it to be very important that such a requirement

cover not only poison pills adopted during a tender offer, as provided in the Dingell-Markey bill, but poison pills adopted at any time. Limiting the requirement to pills adopted during a tender offer would go only a short way toward correcting this abuse, since the great majority of poison pills are adopted before a tender offer is underway. Indeed, as we noted in our testimony, there is usually more than sufficient time to seek shareholder approval for pills of this nature, and no legitimate reason not to require it.

(2) As we stated in our testimony, we are not certain that it is necessary or in the interest of shareholders to ban partial and two-tier offers that are made available to all shareholders, at least in the absence of evidence that these kinds of offers have actually resulted in inequities among different types of shareholders. The SEC has recently concluded that partial offers serve many legitimate business purposes, and that "there is little evidence that individual shareholders have had difficulty in participating in offers for less than all the shares." As we also pointed out, the SEC has also concluded that two-tier offers have diminished to such an extent that any problems which they may have previously presented are now minimal. It may well be that two-tier offers have not in fact harmed shareholders as a group because they have provided a substantial premium to shareholders, a premium that would not exist if no bid at all were made or if a bid were frustrated by the target company.

We do, however, believe that the "creeping tender offer" and "street sweep" -- acquisition techniques which are, by their nature, not available to all shareholders, and which often only professional investors or arbitrageurs can take advantage of -- should be prohibited. The SEC's proration and withdrawal rules do not apply to such techniques, and are of no value in alleviating this abuse. In this regard, we do not believe it to be necessary, as your bill provides, to prohibit all acquisitions of more than specified percentages except by a tender offer for all of the company's stock, unless the offeror agrees to purchase the remaining shares at the same price within six months. However, we do support a provision, such as Section 13 of the Dingell-Markey bill, which prohibits acquisitions in excess of a specified percentage of stock except by tender offer available to all shareholders, but does not require that the tender offer be made for all of the company's stock. In this way, partial and two-tier offers will still be permitted, but creeping tender offers and street sweeps will not.

(3) An acceptable way of dealing with street sweeps is through a provision such as Section 13 of the Dingell-Markey bill, as discussed in our prior answer, and also by Section 11 of that bill, which expressly prohibits market sweeps for thirty days after the termination of a tender offer.

(4) CREF does not believe that it has been manipulated in a takeover contest except that the use of greenmail and poison pill have, in some cases, distorted normal market forces.

(5) CREF believes it has been victimized by greenmail many times over the years. We focused, however, on certain greenmail payments during a two-month period at the end of 1986. In each case CREF held a sizable position in the company involved. The following tables set forth CREF's losses, which we calculate as the difference between the tender

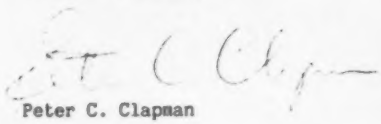
price offered by the outside bidder and the stock's closing price the day the greenmail payment was announced. In those cases in which a tender offer had not been made, the loss is calculated as the difference between the closing price the day before the greenmail payment was announced and the closing price the day of the announcement.

(1) Company	(2) Tender Offer Price and Date	(3) Date of Greenmail Announce- ment	(4) Closing Price	(5) Difference between (2) and (4)	(6) Shares Held by CREF on green- mail Date	(7) Loss to CREF (5)times(6)
CPC Int'l	\$84.50(11/4)*	11/5	\$78	\$ 6.50	425,100	\$ 2.8 million
Goodyear	49 (11/5)	11/20	43	6.00	965,748	5.8 "
Gillette	65(11/14)	11/24	45.875	19.125	584,800	11.2 "
USG	44.875(12/2)*	12/3	43	1.875	582,756	1.1 "
TOTAL LOSS						\$20.9 million

*No tender offer. Price is closing price on day before greenmail announcement.

We appreciate the opportunity to have testified before your subcommittee, and again wish to comment that your proposal, in the main, fairly addresses the many inter-related issues affecting the current takeover scene. We believe that federal action is necessary to correct abuses and are prepared to work with you and your staff further in arriving at appropriate legislation.

Very truly yours,


Peter C. Clapman

PCC/ew

Senator METZENBAUM. Thank you. I have a couple of questions; not too many, as a matter of fact.

Your prepared statement, Mr. Martin, indicates that CREF supports Federal legislation to ban greenmail, close the ten-day window and ban poison pills without shareholder approval. You know the specific proposals I made along that line. Do you have any difficulty with those proposals?

Mr. MARTIN. In terms of the window?

Senator METZENBAUM. Yes.

Mr. MARTIN. No problem at all.

Senator METZENBAUM. And to ban greenmail and to ban poison pills without shareholder approval?

Mr. MARTIN. That, I support completely.

Senator METZENBAUM. Yes.

Mr. MARTIN. In terms of the window, I recognize that your recommendation was 3 percent and I used 5 percent in my remarks. It is true that many institutions will be forced into reporting, not the least of which ours.

Senator METZENBAUM. Pardon?

Mr. MARTIN. We will have many, many positions which will, in fact, exceed 3 percent of the outstanding shares, as will many large institutions. So it is an increasing burden on institutions which really have no interest whatever in takeovers.

Senator METZENBAUM. Do you think that the position of CREF is rather representative of the position of most of the pension fund managers?

Mr. MARTIN. I firmly believe it is. We have talked to many and we have gotten a good deal of support in our poison pill proxy recommendations. I think institutions more and more are beginning to realize that they, in fact, have a duty as owners.

I am offended when people talk about dogs in heat. Our average position is probably held for 7 or 8 years. We have no interest in seeing major corporations disappear off the face of the earth. That reduces our opportunity.

Senator METZENBAUM. I think you could be very helpful to us if you could get your institutions as a group to come forward and indicate support for the legislative proposals we have and such suggestions with respect to changes as might be deemed appropriate because we do not have a closed mind.

I think pretty generally we are moving in the same direction, and I would guess there is an organization of institutional managers.

Mr. MARTIN. There is something known as the Council of Institutional Investors. We do not happen to be a member, but it represents a substantial group of investors.

Senator METZENBAUM. I wonder if you might pass on to them our thoughts, and we will try to reach them as well.

Mr. MARTIN. We will be happy to give you names if you need names.

Senator METZENBAUM. I think that I am just going to close this hearing by asking both of you whether you would come forward and work with us. We want to move a bill; we want it to be reasonable.

We think that the suggestions that both of you have made have merit, but I think we need your help. As I said before, I think on some of these issues there is some understanding, but I think it would be very helpful if you, Al, and Mr. Martin, were good enough to help us.

Mr. MARTIN. We would be most happy to. It is in our interests, too.

Mr. SOMMER. Senator, you have always had my commitment on that. I would just add one thing. I think it is very refreshing to hear Mr. Martin this morning indicate that his type of organization supports legislation, and I think last week the Securities Industry Association that in 1985 opposed all legislation, as I recall it, has announced a legislative program that incorporates some of the ideas that have been discussed here today.

I think that we may be on the threshold of building a consensus among business, labor, the investment banking community, as well as the institutional investors that I think bodes well for the country, and I think everyone should be appreciative for your initiatives.

Senator METZENBAUM. Thank you very much.

We have two statements which we will enter into the record.

[The prepared statements follow:]

STATEMENT OF

CLARENCE E. JOHNSON

PRESIDENT AND CHIEF EXECUTIVE OFFICER

BORG-WARNER CORPORATION

Mr. Chairman and Members of the Subcommittee, I am Clarence E. Johnson, President and Chief Executive Officer of Borg-Warner Corporation.

Our company has a very direct interest in the issue before this Subcommittee. Borg-Warner is currently threatened by takeover.

We know this threat to us will be resolved well before the enactment of any legislation. However, the issue is far more important to the nation than the fate of any one company.

The question of public policy that Congress must address, I submit, is how we as a nation should allocate our capital. Properly, I believe, we should be building plants and funding research, not leveraging our future for the benefit of a few individuals through manipulation and speculation.

The Wall Street scandals have revealed a growing problem with the way in which this country allocates its capital resources. Under the guise of the free enterprise system we are much too tolerant of practices that strain our capital markets and hinder our competitive posture abroad.

The financial and securities sectors of our economy operate rightly in regulated and fair markets, not free markets. Laws and regulations should guide our conduct under clearly defined public policy objectives. And where regulation serves as an intervening force, a more sophisticated analysis is required than the sweeping generalizations we so often hear.

The Need for Corporate Takeovers and Acquisitions

The issue which brings us together is not whether to prohibit corporate takeovers.

Corporate mergers and acquisitions are an essential element of the American enterprise system. They promote economic efficiency and growth. They help build stronger, more competitive companies and allow shareholders to realize the value that has been created.

Even hostile takeovers have their place. The ability to launch such a takeover plays an important role. The marketplace needs a mechanism by which shareholders can receive maximum value for their investment. Recalcitrant management should not be permitted to stand in the way.

The real issue is how manipulation of our securities markets harms American business and lessens our ability to compete overseas.

The Use of the Hostile Takeover Threat as a Means to Manipulate the Securities Market

The current economic and regulatory environment has created a climate in which individuals have been able to manipulate the stock market, very skillfully, for their own financial advantage. Using the threat of a hostile takeover, these individuals create massive speculation in the stock of certain companies for the purpose of generating a quick profit or a greenmail payment.

Seldom do these speculators have any real interest in managing the companies they target. Nothing of value is created by their actions. No plants are built; no jobs are created. Although huge amounts of money are made overnight, almost none of it results in increased economic productivity or efficiency.

The results have been harmful to the economy, to American competitiveness in international markets, and to individual shareholders.

These wealthy speculators have developed a market manipulation scheme reminiscent of the stock pooling and profiteering abuses of the 1920s.

Let me explain how the game works.

Corporate raiders, arbitrageurs, and investment bankers work together to create market speculation in the stock of "targeted" companies. The raiders purchase enough stock to be noticed, the arbitrageurs commence trading, which increases volume and fosters rumors of a takeover, and the mere presence of investment bankers fuels further speculation.

These players con other investors into believing that the raider is serious about a takeover bid. The raiders may make public proposals to buy the company if certain conditions are met and may publicly complain about being denied access to confidential corporate books and records.

But with no requirements for disclosure of their real intent, these speculators can create sufficient pressure to bring some of America's largest corporations to their knees.

The objective is rarely to purchase control. Rather, it is to generate greenmail for the raider, a quick stock profit for the arbitrageur, and fees for the investment banker.

If the raider is skillful enough at creating takeover speculation, the targeted company's stock price moves up in anticipation that someone will pay a premium for control. But the odds are that the deal will never be completed.

We examined 71 of these self-styled "offers" by 15 different raiders. The results were enlightening: in only 20 of the cases--or 28 percent--did the raider actually consummate the deal.

But no matter what the outcome, the raider almost always profits.

This speculation neither creates jobs, nor adds to the national wealth. It simply rearranges ownership interests and shifts risk from shareholders to creditors.

Even knowledgeable observers have been dumbfounded at how quickly and decisively these financial speculators accumulate and manipulate corporate assets. The game has

become so sophisticated that profits can be made with little risk in a matter of hours.

Yet the media and the American public still find romance in these privateers who allege a Robin Hood-like "concern for the small stockholder" as an excuse for their plundering.

But let's not kid ourselves. These people are out to make money for themselves, pure and simple.

A market climate has been created that favors short-term speculation over long-term management of productive assets. The securities markets are no longer the forum where the fundamentals of individual companies and the economy are analyzed and tested. Instead, Wall Street has become a high-stakes poker game of bluff with billions of dollars of corporate assets and thousands of jobs on the table.

Our short-term focus has caused profitable companies to be liquidated for a quick profit and a widespread substitution of debt for equity. We are leveraging for the short-term, and in the process, ignoring the future.

If this dangerous trend continues, American business will not retain its competitive position in the world marketplace.

No company can become or remain successful without long-term perspective, investment and research and development. Responding to current pressures can result in a higher immediate stock price, but at a cost that weakens the business over the long run. Without closer focus on capital expansion and R&D, American companies will not be able to meet the competitive challenges of the international marketplace.

Our market incentives have become distorted. When more money is made by not succeeding in a takeover deal, then I think it is time for us to focus on where we as a nation want to invest our capital.

The Challenge Facing Borg-Warner

The takeover threat facing Borg-Warner illustrates the

inadequacies of the current system. Over the past decade, Borg-Warner has been restructuring itself in a steady evolution that increased value to its shareholders without causing trauma to the organization. Not everything we tried worked. But we accomplished a great deal.

The company has divested non-mainstream operations. It has entered new markets and built these operations into substantial resources.

From 1981 through 1985, before we went into "play," our total return to shareholders, which includes dividends and appreciation, averaged 23.7 percent, compared with 13.7 percent for Standard & Poor's 400. During those same years, we reinvested \$1 billion in our businesses in capital expenditures and more than \$300 million in research and development.

And we did this without over-leveraging the company.

Let me give you two examples of what Borg-Warner has been able to accomplish.

In 1978, Borg-Warner acquired Baker Industries, our initial protective services operation. Its revenues then were \$209 million, and it employed 13,000 people. Nine years later, the business has \$1 billion in revenues and employs about 50,000 people. Half that growth came from additional, small acquisitions; half from internal improvements.

The second example involves one of our research and development initiatives. In 1972, we began exploring the technological possibilities of a "continuously variable" automotive transmission (CVT) that could improve fuel efficiencies through an infinite number of gear speeds, instead of the three, four or five we normally work with.

Fifteen years later, our major CVT component has become the darling of the two-liter engine market. Our customers include Fiat, Honda, Isuzu, Subaru and Toyota. The long-term investment in technology produced results both for our company and for the auto industry.

But it is difficult for a company to keep expanding . . .

into new markets and committing itself to long-term R&D investments when it has to look constantly over its shoulder. And for 15 months, we have had to do just that.

To our knowledge, the threats to takeover Borg-Warner have not involved illegal conduct. However, what emerges is a carefully constructed pattern of behavior, by some, designed to send signals to the market. The only purpose was to influence the price of our stock.

On 16 days between January 1, 1986 and March 20, 1987, for example, Borg-Warner shareholders had abnormal gains or losses. These dates coincided with large block trades on the Midwest and Philadelphia exchanges or the third market--a powerful signal to arbitrageurs that a company is in play. Self-styled "offers" and rumors also were reported by the newswires.

The threat facing Borg-Warner, in my opinion, demonstrates a serious public policy problem. Our securities markets are being misused. The process is weakening industrial effectiveness. That, in turn is stifling our international competitiveness.

Borg-Warner has fought this threat in order to conserve the company's core businesses and build on them. The company has managed to do that throughout the turbulence of the 1980s and intends to continue to do so.

The Need for Corrective Legislation

New market forces are at work here. The current economic and regulatory environment has replaced the creation of genuine industrial strength and wealth with the generation of quick stock profits for some, but far from all investors.

This problem should not be solved by restricting hostile takeovers in their entirety. Instead, Congress should take steps to limit the ability of a few individuals to manipulate the securities markets through the implied threat of a takeover.

Borg-Warner advocates a legislative proposal which strikes a proper balance. It is simple in concept and it addresses the cause of most of the abuses in this area, especially pressures for greenmail. The ideas in this proposal are not new. They have been offered in similar form by others during the last Congress.

Normally, control of a corporation is obtained through a formal offer for all outstanding shares. Under existing law, however, no limits are established as to when that offer must be made. Raiders, therefore, accumulate a minority position in a target company's stock and threaten a hostile takeover until the target company provides them with greenmail or another opportunity to sell their shares at a premium not offered to other shareholders.

The centerpiece of our proposal would require a raider to make a tender offer for all of the targeted company's shares once a threshold level of ownership--say 10 percent--has been accumulated.

This would eliminate harassing and delaying tactics, while permitting legitimate takeover activity to continue. The concept has been endorsed by members of Congress, the Business Roundtable, the AFL-CIO, and most recently, the Securities Industry Association.

In addition, this reform measure would prohibit tender offers that are made without sufficient financing to complete them.

A conceptual outline of this proposal is attached.

Conclusion

Congress needs to pass legislation which will restore balance to the system. Public corporations should produce goods and services, not be instruments of speculation and manipulation. Otherwise, this nation will lose its competitive edge, and we will witness an extraordinary and destabilizing transfer of wealth.

Mr. Chairman, Members of the Subcommittee, thank you for the invitation to testify today. Borg-Warner welcomes the opportunity to lend its assistance to this subcommittee as it considers legislation to solve this important public policy problem.

S. _____

A bill to eliminate certain abuses in hostile corporate takeovers.

SECTION 1. SHORT TITLE.

This Act may be cited as the "Corporate Takeover Reform Act of 1987".

SECTION 2. FINDINGS.

The Congress finds that:

(1) the current regulatory climate permits the unfair manipulation of the price of shares of publicly-traded companies by a few persons to the detriment of shareholders generally;

(2) accumulations of minority share positions in publicly-traded companies are being used to create rumors of takeover in order to put companies "in play";

(3) individual shareholders not having access to the facts underlying this activity need protection to insure fair and equal treatment for their investment;

(4) the share accumulation activities of corporate raiders, arbitrageurs, investment bankers and others should be restricted when its primary objective is not the purchase of control of a company.

SECTION 3. LIMITATION ON STOCK ACCUMULATIONS ("CREEPING TAKEOVERS".)

No person or group should be permitted to acquire more than 10% of a company's voting securities except by a tender offer for all the outstanding voting securities. Exemptions would be provided for certain passive investors and investments agreed to by the company.

Purpose

- To inhibit manipulation of the public securities markets by persons seeking short-run stock profits without an intent to pay a fair price to all shareholders for control of the the company

- To require payment of the economic premium for control of a company to all shareholders

- To force compliance with the Williams Act disclosure requirements for tender offers

Rationale

This provision would eliminate the stock accumulation programs used by corporate raiders to put a company "in play" through rumors of a tender offer for control that rarely materialize. The benefit to the raider of putting the company "in play" is the resulting increase in the price and trading volume of the company's stock that enables him to bring additional pressure on the company to repurchase its shares ("greenmail").

The provision also would eliminate two-tier or partial tender offers which force shareholders to tender hastily or risk receiving a much lower price for their shares later.

At the same time this provision would retain the important ability for a person to make a tender offer for control of a company without its consent.

SECTION 4. PROHIBITION ON HIGHLY CONDITIONAL TENDER OFFERS.

No person or group should be permitted to announce or commence a tender offer that is subject to the ability to obtain financing.

Purpose

- To eliminate the ability to announce or commence tender offers which are subject to availability of financing.
- To eliminate the ability of corporate raiders to commence or announce illusory tender offers which are primarily intended to put a company "in play".

Rationale

A powerful method of putting a company "in play" is the public suggestion or announcement of a tender offer, but which "offer" is subject to several conditions that may be difficult or impossible to meet -- such as obtaining sufficient funds to complete the purchase. Corporate raiders can make this kind of "offer" as an ultimate pressure tactic to force a company to repurchase shares that the raider has accumulated, or to force the company to find another buyer.

This provision would not restrict the bona fide tender offer for control of a company which is rarely commenced without committed financing.

WRITTEN TESTIMONY OF
ROBERT P. REUSS, CHAIRMAN OF THE BOARD
AND CHIEF EXECUTIVE OFFICER
CENTEL CORPORATION

CONCERNING
S. 521: TENDER OFFER IMPROVEMENT ACT OF 1987
AND
S. 227: TENDER OFFER REFORM ACT OF 1987
APRIL 2, 1987

FOR 15 YEARS I HAVE BEEN CHIEF EXECUTIVE OFFICER AND 10 YEARS THE CHAIRMAN OF THE BOARD OF CENTEL CORPORATION, A TELECOMMUNICATIONS COMPANY WHOSE COMMON STOCK IS PUBLICLY HELD AND LISTED ON THE NEW YORK STOCK EXCHANGE AND MIDWEST STOCK EXCHANGE. PRIOR TO JOINING CENTEL, I SPENT 30 YEARS WITH THE BELL SYSTEM IN A VARIETY OF MANAGEMENT POSITIONS. TODAY, I SERVE AS AN OUTSIDE DIRECTOR OF SEVERAL PUBLICLY AND PRIVATELY HELD COMPANIES INVOLVED IN FINANCIAL, MANUFACTURING AND FOOD DISTRIBUTION OPERATIONS AND I AM A GOVERNOR OF THE MIDWEST STOCK EXCHANGE. AS A DIRECTOR, I HAVE BEEN INVOLVED IN THE CHANGE OF CONTROL OF FIVE COMPANIES. AS AN EXECUTIVE, I HAVE BEEN INVOLVED IN GUIDING CENTEL THROUGH THE DEREGULATION OF THE TELECOMMUNICATIONS INDUSTRY AND REFOCUSING CENTEL'S BUSINESS STRATEGY TO INCLUDE NEW GROWTH BUSINESSES SUCH AS CABLE TELEVISION AND BUSINESS COMMUNICATIONS SYSTEMS.

IN MY OPINION, BASED UPON MY EXPERIENCE, THE PLAYING FIELD IS TILTED TOWARD ACQUIRING CORPORATIONS AND TARGET CORPORATIONS ARE AT A DISADVANTAGE. I BELIEVE IN THE FREE MARKET AND RECOGNIZE THAT NO COMPANY SHOULD BE IMMUNE FROM A TAKEOVER. IN ADDITION, I BELIEVE THAT TO WHATEVER EXTENT THERE IS REGULATION IT INTRUDES UPON THE FREE MARKET. ONE MAY ARGUE THAT TENDER OFFER RULES ARE DESIGNED TO PROTECT THE FREE MARKET BUT IT IS NOT NECESSARY TO GET INTO THAT PHILOSOPHICAL DEBATE. WHETHER TO PROTECT MARKET FORCES OR

TO LIMIT THEM, I BELIEVE THE TENDER OFFER RULES SHOULD BE AMENDED TO PROVIDE GREATER INFORMATION TO THE TARGET AND GREATER OPPORTUNITY FOR THE TARGET TO ANALYZE AND REACT RESPONSIBLY TO A TAKEOVER ATTEMPT.

I AM CONCERNED THAT THE OPPORTUNITY FOR SURPRISE ATTACKS IN SHORT PERIODS ADVERSELY AFFECTS CORPORATE MANAGEMENT. THIS SUSCEPTIBILITY CREATES PRESSURE ON MANAGEMENT TO OPERATE THE BUSINESS TO MAXIMIZE ITS STOCK PRICE AND DEVELOP DEFENSES TO ATTACK. THESE SHORT-TERM GOALS ARE GENERALLY NOT CONSISTENT WITH THE LONG-TERM GOAL OF MAXIMIZING SHAREHOLDER VALUE. THEY DIVERT ATTENTION FROM MANAGING FOR PRODUCT OR SERVICE INNOVATION AND QUALITY, EMPLOYEE DEVELOPMENT AND PRODUCTIVE EFFICIENCY. THEY UNDERCUT THE DEVELOPMENT OF LONG RANGE PLANNING AND THE COMPETITIVENESS OF AMERICAN BUSINESS IN THE WORLD ECONOMY. OF COURSE, THIS PROBLEM IS EXACERBATED WHEN THERE IS A THREATENED OR ATTEMPTED TAKEOVER. MANAGEMENT MUST DEVOTE ALL OF ITS ATTENTION TO THE TAKEOVER AND IGNORE ITS PRIMARY OPERATING RESPONSIBILITY.

MANAGEMENT ENTRENCHMENT IS NOT, IN MY JUDGMENT, THE CRITICAL ISSUE. I DO NOT BELIEVE MANAGEMENT SHOULD BE ALLOWED TO THWART A TAKEOVER TO PERPETUATE ITSELF. NOR DO I BELIEVE THAT HAPPENS VERY OFTEN. THE FIDUCIARY DUTIES OF CARE AND LOYALTY OF DIRECTORS ARE ADEQUATE LEGAL STANDARDS TO INDUCE THE BOARD OF DIRECTORS TO RECOGNIZE AND MEET ITS OBLIGATIONS TO THE SHAREHOLDERS. I DO, HOWEVER, HAVE A CONCERN WHICH IS BROADER AND MORE SIGNIFICANT.

MANY BUSINESS ORGANIZATIONS HAVE EVOLVED OVER MANY YEARS AND HAVE RELATIONSHIPS WITH EMPLOYEES, CUSTOMERS, VENDORS AND COMMUNITIES IN WHICH THEY OPERATE. THERE MAY BE SYNERGIES WHICH HAVE DEVELOPED FROM THE AGGREGATION OF BUSINESS UNITS. THE TARGET COMPANY SHOULD HAVE AN OPPORTUNITY TO EVALUATE ITS LONG-TERM GOALS AND ITS ROLE IN THE SOCIETAL INFRASTRUCTURE. IT SHOULD BE ABLE TO COMMUNICATE MANAGEMENT'S VIEW OF THE VALUE OF SUCH ATTRIBUTES AS COMPARED TO A SHORT-TERM FINANCIAL OR ASSET BUST-UP VALUE.

I WILL NOW COMMENT ON THE SPECIFIC PROPOSALS IN S.521.

1. I SUPPORT SECTION 2 WHICH WOULD LOWER THE REPORTING THRESHOLD FROM 5% TO 2%. THE 5% THRESHOLD IS TOO HIGH AND ALLOWS TOO SIGNIFICANT AN ACCUMULATION WITHOUT KNOWLEDGE BY THE MANAGEMENT OR THE SHAREHOLDERS OF THE TARGET. ANY REPORTING THRESHOLD IS ARBITRARY, BUT 2% STRIKES ME AS AN APPROPRIATE LEVEL WHICH WOULD NOT PLACE AN UNDUE BURDEN ON PASSIVE INVESTORS. MANAGEMENT SHOULD BE ENTITLED TO KNOW WHEN SOMEONE HAS ACQUIRED ONE-FIFTIETH OF THE COMPANY.

2. I ALSO SUPPORT EARLIER DISCLOSURE. THE PRESENT 10 DAY PERIOD ALLOWS THE ACQUIRING ENTITY TO CONCEAL FOR TOO LONG ITS IDENTITY AND INTEREST FROM THE TARGET, ITS SHAREHOLDERS AND THE PUBLIC. THERE IS NO LEGITIMATE REASON FOR DELAYING THE RELEASE OF SUCH MATERIAL INFORMATION. PERSONS ACQUIRING AN INTEREST IN A COMPANY DO NOT NEED A SIGNIFICANT PERIOD OF TIME TO PREPARE A SCHEDULE 13D. INDEED, NEARLY ALL OF THE INFORMATION CAN BE PREPARED BEFORE THE THRESHOLD IS REACHED. THE PROPOSED REQUIREMENT OF AN IMMEDIATE PUBLIC ANNOUNCEMENT WHEN THE 2% LEVEL IS REACHED WITH TWO DAYS TO FILE A SCHEDULE 13D AND A 2 DAY MORATORIUM ON FURTHER STOCK ACCUMULATION IS WARRANTED. INVESTORS TRADING IN THE SECURITIES OF A TARGET ARE ALSO ENTITLED TO KNOW OF THE ACQUISITION OF A 2% POSITION SINCE THAT FACT MIGHT AFFECT THEIR INVESTMENT DECISIONS.

IN S.227 THE 5% THRESHOLD WOULD BE RETAINED BUT THE FILING OF SCHEDULE 13D WOULD BE REQUIRED WITHIN 24 HOURS OF ACQUISITION OF THAT AMOUNT. AS I HAVE INDICATED, I BELIEVE 5% IS TOO HIGH A THRESHOLD. I WOULD NOT OBJECT TO A 24 HOUR FILING REQUIREMENT BUT IT MIGHT CREATE PRACTICAL DIFFICULTIES AND 2 DAYS MAY BE MORE REALISTIC. I BELIEVE THE MORE IMPORTANT ASPECT OF BOTH PROPOSALS IS THE REQUIREMENT FOR AN IMMEDIATE PUBLIC ANNOUNCEMENT.

3. S.521 DOES NOT ADDRESS THE ISSUES RELATING TO A GROUP ACTING IN CONCERT EXCEPT TO THE EXTENT IT ADDS THE WORD "VOTING" IN SECTION 14(h)(1). SECTIONS 3(A) AND 3(B) OF S.227 WOULD ALSO EXTEND THE APPLICATION OF SECTION 13(D) OF THE SECURITIES EXCHANGE ACT OF 1934 TO GROUPS ACTING IN CONCERT FOR THE PURPOSE OF VOTING SECURITIES. I SUPPORT

THOSE PROPOSALS. IN ADDITION, I RECOMMEND THAT THE SCOPE OF SECTIONS 13(d) AND 14(d) SHOULD BE BROADENED. THE RECENT DISCLOSURES OF INSIDER TRADING AND TAKEOVER ABUSES MAKE IT CLEAR THAT PERSONS MAY IN FACT ACT IN CONCERT, IN AN INFORMAL MANNER, WHICH IS BEYOND THE SCOPE OF THE LAW. THERE ARE NETWORKS OF RELATIONSHIPS WHICH ALLOW PERSONS TO ACT IN THE SAME MANNER AT THE SAME TIME AS ANOTHER BASED UPON THE ACTION OF THE OTHER OR EVEN A THIRD PARTY. THIS CAN DEVELOP OVER TIME INFORMALLY WITHOUT ANY EXPRESS AGREEMENT. I DO NOT HAVE A SPECIFIC PROPOSAL BUT THE SWEEP OF THE PROVISION SHOULD BE FLEXIBLE, LIKE THE CONCEPT OF "CONTROL" IN OTHER SECURITIES LAW CONTEXTS. PERSONS ACTING IN CONCERT IN FACT SHOULD HAVE THE BURDEN OF DEFENDING FAILURE TO ANNOUNCE THE ACCUMULATION OF A POSITION OR TO FILE SCHEDULE 13D IF IT LATER APPEARS THEY WERE REQUIRED TO DO SO. THEY SHOULD ALSO HAVE THE AFFIRMATIVE OBLIGATION TO DISCLOSE WHETHER THEY ARE ACTING IN CONCERT WITH ANOTHER PERSON. THE CONCEPT OF CONSCIOUS PARALLELISM HAS BEEN ADVOCATED IN THE ANTITRUST CONTEXT. I DON'T KNOW IF IT IS APPROPRIATE THERE OR WOULD APPLY TO CORPORATE TAKEOVERS BUT I SUGGEST A SIMILAR CONCEPT SHOULD BE ADDED TO BROADEN THE SCOPE OF SECTIONS 13(d) AND 14(d).

4. THERE ARE SEVERAL PROPOSALS TO CHANGE THE PERIODS DURING WHICH TENDER OFFERS MUST REMAIN OPEN. S.521 WOULD EXTEND THE PERIOD FROM 20 TO 45 BUSINESS DAYS. S.227 WOULD EXTEND THE PERIOD TO 30 CALENDAR DAYS (WHICH IS APPROXIMATELY THE SAME AS 20 BUSINESS DAYS) EXCEPT IN THE CASE OF A TWO-TIER OR PARTIAL OFFER IN WHICH CASE IT WOULD BE 40 CALENDAR DAYS. OTHERS HAVE TESTIFIED THAT IT SHOULD BE 90 DAYS. I DO NOT HAVE A POSITION ON THESE PROPOSALS AND NOTE THAT IT MAY BE ADVISABLE TO CONTINUE TO DELEGATE AUTHORITY TO THE SEC TO DETERMINE THESE PERIODS. HOWEVER, I OFFER THE OBSERVATION THAT 20 BUSINESS DAYS OR FOUR WEEKS IS A PERIOD OF TIME WHICH MAY PROVIDE ADEQUATE OPPORTUNITY FOR RESPONSE.

A PERIOD OF 90 DAYS OR NEARLY 13 WEEKS IS PROBABLY TOO LONG TO KEEP OPEN ANY FINANCIAL TRANSACTION AND MAY BE UNREALISTIC.

5. IN GENERAL, I BELIEVE AMERICAN CORPORATE MANAGEMENT ACTS RESPONSIBLY IN THE BEST INTERESTS OF SHAREHOLDERS. THE PAYMENT OF GREENMAIL MAY BE JUSTIFIED, IN THE EXERCISE OF BUSINESS JUDGMENT, TO PROTECT A COMPANY'S LONG-TERM STRATEGIC PLANS TO ENHANCE SHAREHOLDER VALUE. IT MAY ALSO AVOID ADVERSE IMPACT ON EMPLOYEES, COMMUNITIES AND OTHER ELEMENTS OF THE SOCIETAL INFRASTRUCTURE TO WHICH I REFERRED EARLIER. NEVERTHELESS, I SUPPORT EFFORTS TO PROHIBIT GREENMAIL. I DO NOT LIKE THE SHAREHOLDER DISCRIMINATION ELEMENT WHICH IS PRESENT. FURTHERMORE, AND PROBABLY MOST IMPORTANT, THIS PROHIBITION WOULD ELIMINATE THE OPPORTUNITY FOR GREENMAIL AND SEPARATE OUT THE SPECULATORS WHO SEEK QUICK GREENMAIL PROFIT FROM INVESTORS WHO ARE GENUINELY INTERESTED IN OBTAINING EITHER AN INVESTMENT POSITION OR CONTROL.

6. I HAVE CHOSEN NOT TO COMMENT ON THE PROPOSED AMENDMENTS TO THE HART-SCOTT-RODINO ACT OR THE PROPOSED ECONOMIC IMPACT STATEMENT. ALTHOUGH I HAVE EXPRESSED CONCERNS WITH THE BROADER IMPLICATIONS OF CORPORATE TAKEOVERS AND RESTRUCTURING I AM NOT CONVINCED THAT AN IMPACT STATEMENT WOULD BE OF VALUE. I WOULD BE RELUCTANT TO SUPPORT AN ADDITIONAL REVIEW PROCESS OR REMEDY BUT WITHOUT THEM THE STATEMENT MIGHT ONLY BE MISCHIEVOUS. ECONOMIC IMPACTS OF THE SAME NATURE CAN RESULT FROM EMPLOYEE RELATIONS, BUSINESS FAILURE OR MANAGEMENT DECISIONS. AS DRAFTED, I THINK SECTION 6 OF S.521 WOULD REQUIRE INFORMATION WHICH COULD NOT BE PROVIDED IN MANY SITUATIONS.

THANK YOU FOR THIS OPPORTUNITY TO COMMENT CONCERNING A SUBJECT WHICH IS CRITICAL TO THE FUTURE OF THE AMERICAN ECONOMY. I BELIEVE AMERICAN BUSINESS SHOULD HAVE GREATER PROTECTION TO PLAN AND IMPLEMENT STRATEGIES FOR LONG TERM GROWTH AND EFFICIENCY. YOUR INTEREST IN THIS SUBJECT IS APPRECIATED.

Senator METZENBAUM. This hearing stands adjourned.
[Whereupon, at 12:16 p.m., the Subcommittee was adjourned.]

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